

PORTUGAL TELECOM SGPS SA
Form 20-F
June 30, 2004

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 20-F

o **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES
EXCHANGE ACT OF 1934**

OR

ý **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

For the fiscal year ended December 31, 2003

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

Commission file number 1-13758

PORTUGAL TELECOM, SGPS, S.A.

(Exact name of Registrant as specified in its charter)

Republic of Portugal

(Jurisdiction of incorporation or organization)

Av. Fontes Pereira de Melo, 40, 1069-300 Lisboa Codex, Portugal

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
American Depositary Shares, each representing one ordinary share, nominal value €1 per share	New York Stock Exchange
Ordinary shares, nominal value €1 each	New York Stock Exchange*

*
Not for trading but only in connection with the registration of American Depositary Shares.

Securities registered or to be registered pursuant to Section 12(g) of the Act: **None**

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Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **None**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

Ordinary shares, nominal value €1 per share	1,254,284,500
Class A shares, nominal value €1 per share	500

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 Item 18

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CERTAIN DEFINED TERMS

Unless the context otherwise requires, the term "*Portugal*" refers to the Republic of Portugal, including the Madeira Islands and the Azores Islands; the term "*Portuguese Government*" refers to the government of the Republic of Portugal and, where the context requires, includes the Portuguese state; the term "*Parliament*" refers to the Assembly of the Republic of Portugal, the legislative body of the Portuguese state; the term "*EU*" refers to the European Union; the term "*EC Commission*" refers to the Commission of the European Communities; the terms "*United States*" and "*U.S.*" refer to the United States of America; the term "*Portugal Telecom*" refers to Portugal Telecom, SGPS, S.A.; and unless indicated otherwise, the terms "*we*," "*our*" or "*us*" refer to Portugal Telecom and its consolidated subsidiaries.

PRESENTATION OF FINANCIAL INFORMATION

We publish our financial statements in Euro, the single European currency adopted by certain participating member countries of the European Union, including Portugal, as of January 1, 1999. Unless otherwise specified, references to "Euros," "EUR" or "€" are to the Euro. References herein to "U.S. dollars," "\$" or "US\$" are to United States dollars. References to "Escudos" or "PTE" are to Portuguese Escudos. References to "Real," "Reais" or "R\$" are to Brazilian Reais. Certain Euro amounts have been translated into U.S. dollars at specified rates. Unless otherwise indicated, U.S. dollar equivalent information for amounts in Euro is based on the noon buying rate in the City of New York for cable transfers in Euros as certified for United States customs purposes by the Federal Reserve Bank of New York on December 31, 2003. For convenience and comparability, figures previously stated in Escudos have been converted to figures in Euros based on the fixed Escudo/Euro exchange rate of PTE 200.482 = €1.00. We are not representing that the Euro or US\$ amounts shown herein could have been or could be converted into US\$ or Euros, as the case may be, at any particular rate or at all. See "*Item 3 Key Information Exchange Rates*" for further information regarding the rates of exchange between Euros and U.S. dollars.

FORWARD LOOKING STATEMENTS

This Form 20-F includes, and documents incorporated by reference herein and future public filings and oral and written statements by our management may include, statements that constitute "forward-looking statements" within the meaning of the United States Private Securities Litigation Reform Act of 1995. These statements are based on the beliefs and assumptions of our management and on information available to management at the time such statements were made. Forward-looking statements include, but are not limited to: (a) information concerning possible or assumed future results of our operations, earnings, industry conditions, demand and pricing for our products and other aspects of our business under "*Item 4 Information on the Company*," "*Item 5 Operating and Financial Review and Prospects*" and "*Item 11 Quantitative and Qualitative Disclosures About Market Risk*"; and (b) statements that are preceded by, followed by or include the words "believes," "expects," "anticipates," "intends," "is confident," "plans," "estimates," "may," "might," "could," "would," the negatives of such terms or similar expressions.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Although we make such statements based on assumptions that we believe to be reasonable, there can be no assurance that actual results will not differ materially from our expectations. Many of the factors that will determine these results are beyond our ability to control or predict. We do not intend to review or revise any particular forward-looking statements referenced in this Form 20-F in light of future events or to provide reasons why actual results may differ. Investors are cautioned not to put undue reliance on any forward-looking statements.

Any of the following important factors, and any of those important factors described elsewhere in this or in other of our SEC filings, among other things, could cause our results to differ from any results that might be projected, forecast or estimated by us in any such forward-looking statements:

material adverse changes in economic conditions in Portugal or Brazil;

exchange rate fluctuations in the Brazilian Real and the U.S. dollar;

risks and uncertainties related to national and supranational regulation;

increased competition resulting from the liberalization of the telecommunications sector in Portugal and Brazil;

the success of our mobile operations in Brazil through our joint venture with Telefónica Móviles;

the development and marketing of new products and services and market acceptance of such products and services; and

the adverse determination of disputes under litigation.

PART I

ITEM 1 IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

We are not required to provide the information called for by Item 1.

ITEM 2 OFFER STATISTICS AND EXPECTED TIMETABLE

We are not required to provide the information called for by Item 2.

ITEM 3 KEY INFORMATION

Selected Consolidated Financial Data

The selected consolidated balance sheet data as of December 31, 2002 and 2003 and selected consolidated statement of income and cash flow data for each of the years ended December 31, 2001, 2002 and 2003 have been derived from our audited consolidated financial statements included herein. The selected consolidated balance sheet data as of December 31, 1999, 2000 and 2001 and selected consolidated statement of income and cash flow data for each of the years ended December 31, 1999 and 2000 have been derived from our audited consolidated financial statements not included herein.

We prepare our audited consolidated financial statements in accordance with Portuguese GAAP, which differs in certain significant respects from U.S. GAAP. See Notes 36, 37 and 38 to our audited consolidated financial statements for an explanation of the differences between Portuguese GAAP and U.S. GAAP. We have provided, in the information below, amounts in accordance with U.S. GAAP of operating revenues, operating income, net income, earnings per share, total assets, total liabilities and shareholders' equity for all periods and dates for which we have provided information.

The information set forth below is qualified by reference to, and should be read in conjunction with, our audited consolidated financial statements and the notes thereto and also "*Item 5 Operating and Financial Review and Prospects*" included in this Form 20-F.

During 1998, we acquired a 10.02% economic interest in, and voting control of, Telesp Celular S.A., or Telesp Celular, a mobile telecommunications operator in the Brazilian state of São Paulo. During 1999, we increased our economic interest in Telesp Celular to 13.92%. In January 2000, all shares of Telesp Celular owned by shareholders other than Telesp Celular Participações S.A., or TCP, were exchanged for newly-issued shares of TCP, and Telesp Celular became the wholly-owned operating subsidiary of TCP. In June 2000, we conducted a tender offer in Brazil for ordinary shares in TCP. As a result of the tender offer, we increased our economic interest in TCP to 29.92%. On November 7, 2000, TCP completed a capital increase in which we subscribed for additional shares in TCP, and, upon acquisition of such shares, our economic interest in TCP increased to 36.20%. In November 2000, after we exchanged with Telefónica our minority interest in Telesp Fixa (the wireline operator in the Brazilian state of São Paulo controlled by Telefónica) for an additional interest in TCP, we increased our economic interest in TCP further to 41.23%, our voting interest to 85.06% and our ownership of TCP's preferred shares to 17.7%. TCP completed a rights offering in September 2002, in which we subscribed to a total of 247,224 million common shares and 326,831 million preferred shares, thereby increasing our economic interest in TCP to 65.12%, our voting interest to 93.7% and our ownership of TCP's preferred shares to 49.8%. In October 2002, in connection with our agreements with Telefónica Móviles, S.A., or Telefónica Móviles (Telefónica's mobile telecommunications subsidiary), for the formation of Brasilcel (the 50/50 joint venture with Telefónica Móviles for mobile operations in Brazil), which operates under the brand name Vivo as of April 2003 and is referred to as Vivo elsewhere in this Form 20-F, we sold a 14.68% stake in TCP to Telefónica Móviles. On December 27, 2002, we transferred the rest of our interest in TCP to Vivo. We now hold, jointly with Telefónica Móviles, an indirect interest in TCP, as well as in the other Brazilian mobile telecommunications companies previously held directly by Telefónica Móviles. See "*Item 4 Information on the Company Our Businesses Brazilian Mobile Business*" and "*Item 4 Information on the Company Strategic Alliances Alliance with Telefónica*".

From July 1, 1998 until the end of 1999, we accounted for our interest in Telesp Celular by the proportional consolidation of its results in our consolidated financial statements in accordance with Portuguese GAAP. For the purposes of the reconciliation of our audited consolidated financial statements with U.S. GAAP, the financial statements of TCP were consolidated from July 1, 1998 using the full consolidation method. Since we increased our economic interest in TCP in 2000, our financial

statements for 2000 and 2001 fully consolidate the results of TCP in accordance with Portuguese GAAP.

As a result of the transfer of our interest in TCP to Vivo on December 27, 2002 and our acquisition of a 50% ownership interest in Vivo as of that date, our consolidated balance sheet as of December 31, 2002 and 2003 proportionally consolidates 50% of Vivo's assets and liabilities. Our consolidated statement of income and cash flow data for the year ended December 31, 2002 includes the full consolidation of TCP's income and cash flows. Our consolidated statement of income and cash flow data for the year ended December 31, 2003 proportionally consolidates 50% of Vivo's income and cash flows.

In February 2001, TCP acquired an 83% indirect economic interest in Global Telecom (corresponding to 49% of the voting rights), a mobile telecommunications company operating in the Brazilian states of Paraná and Santa Catarina. On December 27, 2002, TCP purchased the remaining 51% of the voting shares of the three holding companies that own Global Telecom and as a result holds a 100% indirect economic interest in Global Telecom. Our consolidated results of operations for the year ended December 31, 2002 presented below reflect the results of operations of Global Telecom based on the equity method of accounting. Global Telecom's assets and liabilities as of December 31, 2002 and 2003 are reflected in our consolidated balance sheet through our proportional consolidation of Vivo. Global Telecom's income and cash flows for the year ended December 31, 2003 are reflected in our consolidated statement of income and cash flows for the year ended December 31, 2003 through our proportional consolidation of Vivo's statement of income and cash flow data.

On April 25, 2003, TCP acquired a controlling interest in Tele Centro Oeste Participações, S.A., or TCO, a mobile telecommunications operator in the Midwestern and Northern regions of Brazil. As a result, TCO's assets and liabilities as of December 31, 2003 are reflected in our consolidated balance sheet as of that date through our proportional consolidation of Vivo, and TCO's income and cash flows from May through December 2003 are reflected in our consolidated statement of income and cash flows for the year ended December 31, 2003 through our proportional consolidation of Vivo's statement of income and cash flow data.

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Information provided in U.S. dollars for the year ended December 31, 2003 has been calculated on the basis of the Euro/U.S. dollar exchange rate on that date of €0.7938 = US\$1.00. See "Presentation of Financial Information" and "Exchange Rates".

Year Ended December 31,

	2003	2003	2002	2001	2000	1999
	US\$	EUR	EUR	EUR	EUR	EUR
STATEMENT OF PROFIT AND LOSS DATA:						
Amounts in accordance with Portuguese GAAP						
Operating revenues:						
Services rendered	6,369.6	5,056.5	4,950.9	4,976.3	4,329.8	2,832.4
Sales of merchandise and products	735.1	583.5	492.0	613.5	684.7	213.1
Telephone directory	171.5	136.1	139.1	136.8	131.7	126.1
Total operating revenues	7,276.2	5,776.1	5,582.0	5,726.6	5,146.2	3,171.6
Operating costs and expenses, excluding depreciation and amortization:						
Wages and salaries	889.2	705.9	694.8	668.6	578.1	520.8
Post retirement benefits	280.8	222.9	183.2	140.7	103.4	95.5
Costs of telecommunications	739.6	587.1	622.9	715.1	470.7	161.9
Subsidies	(26.0)	(20.6)	(31.5)	(36.8)	(38.1)	(38.5)
Maintenance and repairs	159.4	126.5	129.2	120.1	105.7	68.9
Own work capitalized	(93.8)	(74.5)	(114.0)	(179.3)	(133.9)	(120.8)
Raw materials and consumables	93.2	74.0	97.2	139.1	97.3	85.4
Costs of products sold	693.0	550.2	462.7	619.8	658.0	238.4
Telephone directories	113.9	90.4	92.0	89.2	87.1	82.2
Marketing and publicity	178.8	141.9	108.8	142.0	157.5	68.5
Concession rent			16.3	12.7	20.8	20.6
Other general and administrative	1,217.5	966.5	925.6	998.9	848.9	388.3
Provision for doubtful receivables, inventories & other	164.8	130.8	132.8	130.7	188.6	63.5
Other net operating income	(113.4)	(90.0)	(45.3)	(45.3)	(51.9)	(47.5)
Taxes other than income taxes	122.4	97.1	77.8	87.1	95.7	34.5
Total operating costs and expenses, excluding depreciation and amortization	4,419.5	3,508.4	3,352.5	3,602.6	3,187.9	1,621.7
Operating income before depreciation and amortization (EBITDA)	2,856.6	2,267.7	2,229.5	2,124.0	1,958.3	1,549.9
Depreciation and amortization	1,201.7	954.0	962.8	956.2	1,021.5	636.7
Operating income	1,654.9	1,313.7	1,266.7	1,167.8	936.8	913.2
Other expenses, net	302.8	240.3	543.9	1,063.5	423.8	261.5
Work force reduction program costs	395.7	314.1	53.7	183.9	252.7	457.7
Extraordinary items	78.0	62.0	15.6	281.1	(496.4)	(540.5)
Income before income taxes	878.4	697.3	653.5	(360.7)	756.7	734.5
Provision for income taxes	(476.0)	(377.9)	(337.1)	(174.6)	(258.6)	(241.9)
Consolidated net income before minority interests	402.4	319.5	316.4	(535.3)	498.1	492.6
Loss (income) applicable to minority interests	(99.8)	(79.2)	74.6	342.7	42.3	2.1

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Year Ended December 31,

Consolidated net income	302.6	240.2	391.1	(192.6)	540.3	494.7
Operating income per ordinary share, A share and ADS(1)	1.32	1.05	1.01	0.93	0.78	0.87
Earnings per ordinary share, A share and ADS(1)	0.24	0.19	0.31	(0.15)	0.45	0.47
Cash dividends per ordinary share, A share and ADS(1)(2)(3)	0.28	0.22	0.16	0.10		0.20
Share capital	1,580.0	1,254.3	1,254.3	1,254.3	1,201.8	1,045.0

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Amounts in accordance with U.S. GAAP						
Operating revenues	5,618.3	4,460.0	6,007.7	6,042.8	5,199.9	4,107.3
Operating income as restated(6)	910.8	723.1	383.2	696.1	395.8	592.7
Net income before change in accounting principles as restated(6)	183.3	145.5	1,315.3	208.1	66.8	532.8
Cumulative effect of a change in accounting principles SAB 101					(126.7)	
Cumulative effect of a change in accounting principles SFAS 133				(57.5)		
Cumulative effect of a change in accounting principles SFAS 142			(1,038.9)			
Cumulative effect of a change in accounting principles SFAS 143	(9.3)	(7.4)				
Net income after change in accounting principles as restated(6)	174.0	138.2	276.4	150.6	(59.8)	532.8
Earnings per ordinary share, A share and ADS as restated(4)(6)	0.14	0.11	0.22	0.12	(0.05)	0.54
Diluted net income per share as restated(5)(6)	0.14	0.11	0.21	0.12	(0.05)	0.53
On a pro-forma basis(7)						
Net income before change in accounting principles SAB 101 as restated(6)	174.0	138.2	276.4	150.6	66.8	532.8
Net income after change in accounting principles SAB 101 as restated(6)	174.0	138.2	276.4	150.6	(59.8)	528.5
Earnings per ordinary share, A share and ADS after change in accounting principles SAB 101 as restated(4)(6)	0.14	0.11	0.22	0.12	(0.05)	0.53
Diluted net income per share after change in accounting principles SAB 101 as restated(5)(6)	0.14	0.11	0.21	0.12	(0.05)	0.52

- (1) Based on 1,045,000,000 ordinary and A shares issued in the year ended December 31, 1999, 1,201,750,000 ordinary and A shares issued in the year ended December 31, 2000 and 1,254,285,000 ordinary and A shares issued in the years ended December 31, 2001, 2002 and 2003.
- (2) Dividends for the year ended December 31, 2000 were not paid.
- (3) Cash dividends per ordinary share, A share and ADS for the years ended December 31, 1999, 2001, 2002 and 2003 in US\$ were US\$0.20, US\$0.09, US\$0.17 and US\$0.28, respectively.
- (4) Based on the weighted average number of shares as of the date given and taking into account the number of shares issued pursuant to capital increases and all treasury shares, there were 991,182,122 shares for the year ended December 31, 1999, 1,091,826,182 shares for the year ended December 31, 2000, 1,228,392,386 shares for the year ended December 31, 2001, 1,253,880,328 shares for the year ended December 31, 2002 and 1,249,778,188 shares for the year ended December 31, 2003.
- (5) The weighted average number of shares is computed as a weighted average as of the date given and taking into account the number of shares from the exchangeable bonds issued on June 4, 1999 and December 6, 2001, assuming conversion of the bonds into ordinary shares. For the years ended December 31, 2000, 2001 and 2003, the effects of the exchangeable bonds have been excluded from the calculation of diluted earnings per share since they would be antidilutive.
- (6) Operating income and net income for the years ended December 31, 1999, 2000 and 2001 have been restated to include the effect of the reduction in the reported amortization expense for the translated carrying value of goodwill in Portugal Telecom's investment in Telesp Celular Participações, as discussed in Note 36 c1) to our audited consolidated financial statements.
- (7) The pro-forma information shows the application of SAB 101, as if it had been applied in the year ended December 31, 1999.

Year Ended December 31,

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Year Ended December 31,

2003	2003	2002	2001	2000	1999
US\$	EUR	EUR	EUR	EUR	EUR

CASH FLOW DATA:

Amounts in accordance with Portuguese GAAP

Cash flows from operating activities	2,940.2	2,334.0	2,092.3	1,475.4	1,357.6	1,109.6
Cash flows from investing activities	(578.9)	(459.5)	(1,009.6)	(2,528.5)	(2,343.2)	(741.3)
Cash flows from financing activities	(2,083.7)	(1,654.1)	(486.1)	1,839.9	1,131.0	(1,425.6)

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Year Ended December 31,

	2003	2003	2002	2001	2000	1999
	US\$	EUR	EUR	EUR	EUR	EUR

(in millions, except number of ordinary shares)

BALANCE SHEET DATA:

Amounts in accordance with Portuguese GAAP

Current assets	6,348.5	5,039.7	4,850.9	3,628.1	2,032.6	1,205.1
Investments, net	564.4	448.1	376.4	2,000.3	1,295.3	1,498.2
Fixed assets, net	5,376.3	4,268.0	4,575.8	5,491.3	5,446.2	3,855.9
Intangible assets post retirement benefits				761.9	495.0	399.1
Intangible assets other, net	3,968.2	3,150.1	2,968.7	4,934.4	3,878.8	1,492.3
Other non-current assets, net	821.3	652.0	954.3	820.3	68.3	67.1
Total assets	17,078.8	13,557.8	13,726.1	17,636.3	13,216.2	8,517.7
Current liabilities	4,225.6	3,354.5	2,958.0	3,240.0	3,154.2	1,535.6
Long-term debt	5,738.7	4,555.6	5,219.1	5,428.3	2,815.2	2,649.6
Accrued post retirement liability	1,582.2	1,256.0	1,061.5	1,810.0	1,488.0	1,228.0
Deferred income investment subsidies	48.8	38.7	51.1	63.1	113.7	153.4
Deferred income post retirement benefits				23.0	26.2	28.5
Other non-current liabilities	967.6	768.1	878.0	1,685.1	143.7	85.4
Total liabilities	12,563.0	9,973.0	10,167.6	12,249.5	7,741.0	5,680.5
Net assets	4,515.8	3,584.8	3,558.5	5,386.7	5,475.2	2,837.2
Minority interests	811.2	644.0	447.2	1,220.0	1,113.1	78.2
Total shareholders' equity	3,704.6	2,940.8	3,111.3	4,166.8	4,362.1	2,759.0
Total liabilities and shareholders' equity	17,078.8	13,557.8	13,726.1	17,636.3	13,216.2	8,517.7
Number of ordinary shares	1,254,284,500	1,254,284,500	1,254,284,500	1,254,284,500	1,201,749,500	935,750,000

Amounts in accordance with U.S. GAAP

Total assets as restated(1)	14,819.4	11,764.3	12,554.2	16,747.8	14,534.6	11,958.7
Total liabilities as restated(1)	12,045.3	9,562.1	10,167.9	11,902.5	9,019.4	7,121.8
Total shareholders' equity as restated(1)	2,518.1	1,999.0	2,343.7	3,736.5	4,191.8	3,342.3

(1)

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Assets, liabilities and shareholders' equity as of December 31, 2001, 2000 and 1999 have been restated to include the effect of translation of goodwill in Telesp Celular Participações and the minimum pension liability adjustment, as discussed in Note 36 c1) to our audited consolidated financial statements.

Exchange Rates

Euro

Effective January 1, 1999, Portugal joined ten other member countries of the European Union in adopting the Euro as the common currency. During the transition period between January 1, 1999 and December 31, 2001, the Escudo remained legal tender in Portugal as a denomination of the Euro, and public and private parties paid for goods and services in Portugal using either the Euro or the Escudo. On January 1, 2002, the Euro entered into cash circulation, and from January 1, 2002 through February 28, 2002, both the Euro and the Escudo were in circulation in Portugal. From March 1, 2002, the Euro became the sole circulating currency in Portugal.

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For the years ended December 2001, 2002 and 2003, the majority of our revenues, assets and expenses were denominated in Euro, although a significant portion of our assets and liabilities are denominated in Brazilian Reais and certain of our liabilities are denominated in U.S. dollars. We have published our audited consolidated financial statements in Euro and our shares trade in Euro on the Euronext Lisbon Stock Exchange. Our financial results could be affected by exchange rate fluctuations in the Brazilian Real and U.S. dollar. See "Item 5 Operating and Financial Review and Prospects Liquidity and Capital Resources Exchange Rate Exposure to the Brazilian Real and the U.S. Dollar".

Our future dividends, when paid in cash, will be denominated in Euros. As a result, exchange rate fluctuations have affected and will affect the U.S. dollar amounts received by holders of ADSs on conversion of such dividends by The Bank of New York as the ADS depository. The Bank of New York converts dividends it receives in foreign currency into U.S. dollars upon receipt, by sale or such other manner as it has determined, and distributes such U.S. dollars to holders of ADSs, net of The Bank of New York's expenses of conversion, any applicable taxes and other governmental charges. Exchange rate fluctuations may also affect the U.S. dollar price of the ADSs on the New York Stock Exchange.

The following tables show, for the period and dates indicated, certain information regarding the U.S. dollar/Euro exchange rate. The information is based on the noon buying rate in the City of New York for cable transfers in Euro as certified for United States customs purposes by the Federal Reserve Bank of New York. On June 15, 2004, the Euro/U.S. dollar exchange rate was €0.8231 per US\$1.00.

Year ended December 31,	Average Rate(1)
	(EUR per US\$1.00)
1999	0.9447
2000	1.0873
2001	1.1217
2002	1.0561
2003	0.8786

(1) The average rate is calculated as the average of the noon buying rates on the last day of each month during the period.

Period	High	Low
	(EUR per US\$1.00)	
December 31, 2003	0.7989	0.7907
January 31, 2004	0.8095	0.8009
February 29, 2004	0.8079	0.8009
March 31, 2004	0.8220	0.8116
April 30, 2004	0.8389	0.8332
May 31, 2004	0.8209	0.8168

None of the 25 member countries of the European Union has imposed any exchange controls on the Euro.

Brazilian Real

Although the majority of our revenues, assets and expenses are denominated in Euros, most of the revenues, assets and expenses from our Brazilian investments are denominated in Brazilian Reais. Consequently, exchange rate fluctuations between the Euro and the Brazilian Real affect our revenues.

There are two principal legal foreign exchange markets in Brazil: the commercial rate exchange market and the floating rate exchange market.

Most trade and financial foreign-exchange transactions are carried out on the commercial rate exchange market. These transactions include the purchase or sale of shares or payment of dividends or interest with respect to shares. Foreign currencies may only be purchased through a Brazilian bank authorized to operate in these markets. In both markets, rates are freely negotiated but may be influenced by Central Bank intervention. In 1999, the Central Bank placed the commercial rate exchange market and the floating rate exchange market under identical operational limits, which led to a convergence in the pricing and liquidity of both markets. Since February 1, 1999, the floating market rate has been the same as the commercial market rate, and the system relying on the foreign exchange rate band has been eliminated. However, there is no guarantee that these rates will continue to be the same in the future. Despite the convergence in pricing and liquidity of both markets, each market continues to be regulated separately.

The Brazilian government may impose temporary restrictions on the conversion of Reais into foreign currencies and on the remittance to foreign investors of proceeds from their investments in Brazil. Brazilian law permits the government to impose these restrictions whenever there is a serious imbalance in Brazil's balance of payments or reason to foresee a serious imbalance.

The following tables show, for the periods and date indicated, certain information regarding the Real/U.S. dollar exchange rate. On June 15, 2004, the Real/U.S. dollar exchange rate was R\$3.1227 per US\$1.00. The information is based on the noon buying rate in the City of New York for cable transfers in Brazilian Reais as certified for United States customs purposes by the Federal Reserve Bank of New York.

Year ended December 31,	Average Rate(1)
	(R\$ per US\$1.00)
1999	1.8641
2000	1.8333
2001	2.3507
2002	2.9886
2003	3.0565

(1) The average rate is calculated as the average of the noon buying rates on the last day of each month during the period.

Period	High	Low
	(R\$ per US\$1.00)	
December 31, 2003	2.9070	2.8785
January 31, 2004	2.9581	2.9170
February 29, 2004	2.9447	2.9085
March 31, 2004	2.9117	2.9010
April 30, 2004	2.9705	2.9370
May 31, 2004	3.1650	3.0770

Escudo

As of January 1, 2002, we ceased to use the Escudo. For the years ended December 31, 2001, 2002 and 2003, the majority of our revenues, assets and expenses were denominated in Euros. As a result, revenues, assets and expenses for years prior to 2001 have been translated from Escudos into Euros. All figures previously stated in Escudos have been converted to figures in Euro based on the fixed Escudo/Euro exchange rate, established on January 1, 1999, of PTE 200.482 per €1.00 or approximately €0.005 per PTE 1.00. See "Euro".

Risk Factors

Rapidly Growing Competition From Mobile Telephone and From Other Wireline Operators Could Significantly Reduce Our Wireline Businesses' Revenues

During 2003, approximately 37% of our consolidated revenues were derived from services provided by our wireline business in Portugal. Currently, the competition for these services comes from the rapid growth of mobile telephone services and from other wireline providers. As a result of the substitution of mobile for fixed telephone services, combined with the increase in competition, we have experienced, and may continue to experience, erosion of market share of both access lines and of outgoing domestic and international traffic. The number of active mobile telephone cards in Portugal has overtaken the number of wireline main lines. Some of our wireline customers are using mobile services as an alternative to wireline telephone services. Mobile operators can by-pass our international wireline network by interconnecting directly with wireline and mobile networks either in our domestic network or abroad. Competition is also forcing down the prices of our wireline telephone services for long distance and international calls. Lowering our international call prices has caused a significant decline in our revenues from international wireline telephone services.

The Portuguese telecommunications sector was opened to full competition on January 1, 2000. As a result, competitive pressure on our wireline telephone services has intensified. Other companies are now allowed to offer wireline telephone services to the general public. They can connect transmission lines they lease from us or from new network operators to our local and long distance network. They are also allowed to build their own networks.

The decrease in wireline traffic and lower tariffs resulting from competition could significantly harm our overall revenues. See "Item 4 Information on the Company Competition Competition Facing our Wireline Business".

A Growing Percentage of Our Revenue Is Derived From Businesses That Are Subject to Rapid and Sometimes Unpredictable Changes in Technology and to Increasing Competition

During 2003, approximately 63% of our consolidated revenues were derived from businesses other than our wireline business in Portugal. These businesses include mainly mobile telecommunications and multimedia services, particularly in Portugal and Brazil.

We believe that the development of mobile telecommunications and multimedia services presents our company with appreciable growth opportunities. However, the success of our mobile telecommunications and multimedia businesses is subject to rapid and sometimes unpredictable changes in technology and to increasing competition. These businesses also may have unforeseen capital requirements and shifts in customer preferences and demographics. Our business and financial results could suffer:

if we fail to compete effectively in these new businesses and markets;

if we fail to adapt on a timely and efficient basis to changes in technology;

if we cannot attract and retain employees with the requisite skill level necessary to build these new businesses; or

if customer usage does not increase, or if it declines or evolves away from the technologies and businesses in which we are investing.

Burdensome Regulation in an Open Market May Put Us at a Disadvantage to Our Competitors

The Portuguese telecommunications sector is highly competitive and is now fully open to competition. The Portuguese government, however, still imposes on us regulatory restrictions and

obligations dating from the previous monopoly environment. Many of the restrictions and obligations do not apply to other telecommunications operators and service providers in Portugal. The substantial resources we must commit to fulfill these obligations could adversely affect our ability to compete. See "*Item 4 Information on the Company Regulation Portugal*".

Regulation of Our Interconnection Rates Could Give Other Service Providers an Unfair Competitive Advantage

European Union and Portuguese regulations require us to allow other telecommunications network operators and service providers to connect their networks to ours and to terminate calls for them. We believe the interconnection rates should reflect the cost of operating our network in Portugal. The Portuguese regulatory authorities may, however, set our rates at levels comparable to rates in certain other EU countries, where interconnection rates are lower than the current rates in Portugal. See "*Item 4 Information on the Company Regulation Portugal*".

The Portuguese Government Could Terminate Our Wireline Concession and Licenses

Through our subsidiary PT Comunicações, S.A., we provide a significant number of services under a Concession and licenses granted to us by the Portuguese government. The Concession runs until 2025, with provisions for renewal. The Portuguese government can revoke the Concession after 2010, if it considers the revocation to be in the public interest. It can also terminate our Concession at any time if we fail to comply with our obligations under it. The Portuguese government can also terminate our licenses under certain circumstances. If the Portuguese government took such action, we would not be able to conduct the activities authorized by the Concession or the relevant licenses. This loss would eliminate an important source of our revenues. During 2002, we acquired the ownership of the basic network used for our fixed line services and such assets will no longer revert to the Portuguese State on termination of the Concession Agreement.

Regulatory Investigations and Litigation May Lead to Fines or Other Penalties

We are regularly involved in litigation and regulatory inquiries and investigations involving our operations. ANACOM, the Portuguese telecommunications regulator, the European Commission and the Autoridade da Concorrência, the Portuguese competition authority, can make inquiries and conduct investigations concerning our compliance with applicable laws and regulations. Current inquiries and investigations include a preliminary investigation by the Autoridade da Concorrência relating to alleged anti-competitive practices by PT Comunicações and PT Prime. See "*Item 4 Information on the Company Regulation Regulatory Institutions*" and "*Item 8 Financial Information Legal Proceedings Regulatory Proceedings*".

If we are found to be in violation of applicable laws and regulations in this or other regulatory inquiries and investigations, or in litigation proceedings, which are currently pending against us or which may be brought against us in the future, we may become subject to substantial penalties, fines, damages or other sanctions. Any adverse outcome could have a material adverse effect on our operating results or cash flows.

The Portuguese Government Holds All of Our A Shares Which Afford It Special Approval Rights

All of our A shares are held by the Portuguese government. Under our articles of association, as the holder of all of our A shares, the Portuguese government may veto a number of actions of our shareholders, including the following:

election of one-third of the directors, including the chairman of the board of directors;

authorization of a dividend in excess of 40% of our distributable net income in any year;

capital increases and other amendments to our articles of association;

issuance of bonds and other securities;

authorization for a shareholder that is engaged in an activity in competition with us to hold more than 10% of our ordinary shares;

altering our general objectives, strategy or policies; and

defining our investment policies, including the authorization of acquisitions and disposals.

An ADS Holder May Face Disadvantages Compared to an Ordinary Shareholder When Attempting to Exercise Voting Rights

Holders of our ADSs may instruct the depositary to vote the ordinary shares underlying the ADSs. For the depositary to follow the voting instructions, it must receive them on or before the date specified in our voting materials. The depositary must try, as far as practical, subject to Portuguese law and our articles of association, to vote the ordinary shares as instructed. In most cases, if the ADS holder does not give instructions to the depositary, it may vote the ordinary shares in favor of proposals supported by Portugal Telecom's board of directors, or, when practicable and permitted, give a discretionary proxy to a person designated by us. We cannot be certain that ADS holders will receive voting materials in time to ensure that they can instruct the depositary to vote the underlying ordinary shares. Also, the depositary is not responsible for failing to carry out voting instructions or for the manner of carrying out voting instructions. This means that ADS holders may not be able to exercise their right to vote and there may be nothing they can do if their ordinary shares or other deposited securities are not voted as requested.

We Are Exposed to Exchange Rate and Interest Rate Fluctuations

We are exposed to exchange rate fluctuation risks mainly due to the significant level of our investments in Brazil. These investments are not hedged against exchange rate fluctuations. We are required to make adjustments to our equity on our balance sheet in response to fluctuations in the value of foreign currencies in which we have made investments. For example, as of December 31, 2003, cumulative foreign currency transaction adjustments related to investments in Brazil were negative €2,234.0 million. Further devaluations in the Brazilian Real could result in further negative adjustments. See "*Item 5 Operating and Financial Review and Prospects Liquidity and Capital Resources Equity*" and "*Item 5 Operating and Financial Review and Prospects Liquidity and Capital Resources Exchange Rate Exposure to the Brazilian Real and the U.S. Dollar*".

All of the debt of our Brazilian subsidiaries is either Real-denominated or has been swapped into Reais and, thus, is not exposed to exchange rate fluctuations.

We are also exposed to interest rate fluctuation risks. We have entered into financial instruments to reduce the impact on our earnings of an increase in market interest rates, but there can be no assurance that such instruments will continue to reduce the impact of interest rate fluctuations in the future or that these financial instruments will prevent unexpected and material fluctuations of interest rates from having any material adverse effect on our earnings.

An Economic Crisis in Brazil Could Reduce Expected Returns on Our Brazilian Investments

A material portion of our business, prospects, financial condition and results of operations is dependent on general economic conditions in Brazil. In particular, it depends on economic growth and its impact on demand for telecommunications and other related services. Since 1998, we have made

significant investments in Brazil. The major factors that could have a material adverse effect on our investments and results of operations in Brazil, including Vivo, are:

Adverse political and economic conditions. The Brazilian government has exercised, and continues to exercise, significant influence over the Brazilian economy. The Brazilian government has utilized salary and price controls, currency devaluation and foreign exchange controls as tools in its previous attempts to stabilize the Brazilian economy and control inflation. Changes in the government's exchange control policy, or in general economic conditions in Brazil, could have a material adverse effect on the results of our operations in Brazil. Deterioration in economic and market conditions in other countries (mainly in other Latin American and emerging market countries) may adversely affect the Brazilian economy and our business.

Devaluation of the Real and increases in interest rates. The Brazilian currency has historically experienced frequent devaluations. The Real devalued against the Euro by 1.1% in 2000, by 12.8% in 2001 and by 81.4% in 2002. During 2002, the Real underwent significant devaluation due in part to political uncertainty in connection with the elections and the global economic slowdown. In the period leading up to, and after, the general election in 2002, there was substantial uncertainty relating to the policies that the new government would pursue, including the potential implementation of macroeconomic policies that would differ significantly from those of the prior administration. This uncertainty resulted in a loss of confidence in the Brazilian capital markets, and the continued devaluation of the Real. The Real appreciated during 2003 against the Euro by 0.11% amidst indications that the new government is doing better than expected. Any substantial negative reaction to the policies of the Brazilian government could have a negative impact, including devaluation. The devaluation of the Real could negatively affect the stability of the Brazilian economy. A devaluation of the Real relative to the Euro could negatively affect the profitability and results of our operations. It would also increase costs associated with financing our operations in Brazil. In addition, a devaluation of the Real relative to the U.S. dollar may increase the costs of imported products and equipment. Our operations in Brazil rely on imported equipment and, as a result of such devaluation, such equipment would be more expensive to purchase.

As all debt issued in Brazil is denominated in or swapped into Real, a devaluation of this currency against the Euro could decrease our total debt, although this impact could be offset by the differential between Euro and Real interest rates.

The current international economic environment is unfavorable, and the flow of foreign investments into Brazil may be diminishing. To make up for the decrease in foreign and invested capital and revenue, the Brazilian government may have to raise funds at higher interest rates. A slowdown of the U.S. economy may also adversely affect the Brazilian economy, as well as interest rates in Brazil. An increase in interest rates could negatively affect our profitability and results of operations and would increase the costs associated with financing our operations in Brazil. In addition, such an increase would raise our interest costs because part of the interest on our debt is floating, primarily in relation to Real-denominated debt, which floats based on the commercial rate exchange market.

Inflation in Brazil. Brazil has historically experienced extremely high rates of inflation. Inflation, as well as governmental measures put in place to combat inflation, have had a material adverse effect on the Brazilian economy. Since the implementation of the Real Plan in 1994, the rate of inflation has been substantially lower than in previous periods. However, inflationary pressures persist, and actions taken in an effort to curb inflation, coupled with public speculation about possible future governmental actions, have contributed to economic uncertainty in Brazil and heightened volatility in the Brazilian securities market. The general price index, or the IGP-DI (the Índice Geral de Preços Disponibilidade Interna), an inflation index developed by the Fundação Getúlio Vargas, a private Brazilian economic organization, reflected inflation of 7.67% in 2003 compared to 26.41% in 2002 and 10.40% in 2001. If Brazil continues to experience significant inflation, Vivo may be unable to increase service rates to its

customers in amounts that are sufficient to cover its increasing operating costs, and its business may be adversely affected, which could in turn have an adverse effect on our results of operations.

Our Strategy of Enhancing Our Mobile Operations in Brazil Through Our Joint Venture With Telefónica Móviles May Not Be Successful

The successful implementation of our strategy for our mobile operations in Brazil depends on the development of our mobile services joint venture company with Telefónica Móviles. On December 27, 2002, we and Telefónica Móviles transferred our direct and indirect interests in Brazilian mobile operators to the mobile services joint venture company, Brasilcel, operating under the brand name Vivo, with headquarters in the Netherlands.

As in any joint venture, it is possible that Telefónica Móviles and we will not agree on Vivo's strategy, operations or other matters. Any inability of Telefónica Móviles and us to operate Vivo jointly could have a negative impact on Vivo's operations, which could have a negative impact on our strategy in Brazil and could have a material adverse effect on our results of operations. In addition, we cannot be sure that Vivo will be able to take advantage of its position in the Brazilian market to increase the scope and scale of its operations or that any anticipated benefits of the joint venture will be realized. See "*Item 4 Information on the Company Strategic Alliances Alliance with Telefónica*".

Regulation May Have a Material Adverse Effect on Vivo's Results

Our mobile business in Brazil is subject to extensive government regulation, including certain regulatory restrictions and obligations relating to licenses, competition, taxes and rates (including interconnection rates) applicable to mobile telephone services. Changes in the regulatory framework and the opening of the market to other competitors in the mobile telecommunications sector may have a negative impact on Vivo's revenues and results of operations. Moreover, Vivo's operating subsidiaries are restricted from increasing some of the rates that they charge for services provided even if the devaluation of the Real and an increase of interest rates by the Brazilian government increase their costs. Such circumstances may limit Vivo's flexibility in responding to market conditions, competition and changes in its cost structure, which could have a material adverse effect on its results of operations and in turn adversely affect our results of operations.

The Conditions Applying to Vivo's Subsidiaries Under the New SMP Licensing Regime May Result in Reducing Our Revenues and Results of Operations

In September 2000, ANATEL, the Brazilian telecommunications regulator, introduced a new mobile services licensing regime, referred to as the SMP regime. The SMP regime permits existing mobile service providers operating under concessions to migrate to the SMP regime and become SMP license holders. Each of Vivo's subsidiaries has migrated to the SMP regime and now holds a SMP license instead of their previous concessions.

The new SMP regime imposes restrictions on the provision of wireline services. As a result of the restrictions, because ANATEL considers Vivo's subsidiaries to be affiliated with Telefónica, which provides wireline long distance services in the state of São Paulo and was awarded a license to provide such services nationwide, ANATEL will not award a wireline long distance license to any of Vivo's subsidiaries. As a result, Vivo's subsidiaries no longer receive revenues from wireline long distance services but receive revenues from interconnection fees paid by wireline long distance operators for wireline long distance traffic originating and terminating on their networks. The interconnection fees do not fully compensate, however, for the loss of wireline long distance revenues, and this has had a negative impact on the overall revenues of Vivo's subsidiaries.

Under the SMP regime, an SMP mobile operator will pay for the use of another SMP mobile operator's network in the same authorization area only if the traffic carried from the first operator to

the second exceeds 55% of the total traffic exchanged between them. In that case, only those calls that have surpassed the 55% level will be subject to payment for network usage. This rule is valid until June 30, 2005, after which no payments will be due for network usage between SMP networks, regardless of the amount of traffic. As a result, if the traffic Vivo's subsidiaries terminate for other SMP mobile operators exceeds the traffic other SMP mobile operators terminate for Vivo's subsidiaries, Vivo's, and consequently our, revenues and results of operations may be adversely affected. See "*Item 4 Information on the Company Regulation Brazil SMP Regulation*".

Interconnection Negotiations May Not Result in Sufficiently Remunerative Revenues for Terminating Calls on the Mobile Networks of Vivo's Subsidiaries and May Negatively Affect our Revenues

Under the new SMP regime, interconnection fees for termination of calls on mobile networks will be determined by commercial negotiation between Vivo's subsidiaries and the wireline operators after June 30, 2004. The conditions of the network usage fee negotiations will be regulated by ANATEL. Because a significant number of mobile subscribers use prepaid mobile services and typically receive more calls than they make, Vivo's subsidiaries derive an important part of their revenues from the interconnection fees paid to them by the wireline operators due to traffic originating on wireline networks and terminating on their mobile networks. If the interconnection fees are reduced, operating revenues may be negatively affected as a result.

Vivo Faces Substantial Competition in Each of its Markets that may Reduce its Market Share and Harm our Financial Performance

Since the opening of the Brazilian market for mobile telecommunications services to competition in 1998, several licenses have been granted for mobile telecommunications services in the areas where Vivo's subsidiaries operate. The introduction of the SMP regime has further increased the number of licensees, which has intensified competition. There has been consolidation in the Brazilian telecommunications market, and we believe this trend may continue. Consolidation may result in increased competitive pressures within the market, for example if financially stronger companies are better positioned to compete with Vivo's subsidiaries or if some brand names become better known than others. Vivo's subsidiaries may be unable to respond adequately to pricing and other competitive pressures resulting from consolidation, which would adversely affect their businesses, financial condition and results of operations. The level of competition from wireline service providers is also increasing. Failure by Vivo's subsidiaries to compete successfully could result in them losing market share and revenues. For more information about the various bands of licenses granted for mobile services in Vivo's coverage areas and competing operators, see "*Item 4 Information on the Company Competition Competition Facing Vivo in Brazil*".

ITEM 4 INFORMATION ON THE COMPANY

Overview

Portugal Telecom's legal and commercial name is Portugal Telecom, SGPS, S.A. Portugal Telecom is a limited liability holding company, organized as a *Sociedade Gestora de Participações Sociais* under the laws of the Republic of Portugal. The company was originally incorporated as Portugal Telecom, S.A., a *sociedade anónima* in June 1994. Our principal offices are located at Avenida Fontes Pereira de Melo, 40, 1069-300 Lisboa, Portugal. Our telephone number is +351 21 500 1701 and our facsimile number is +351 21 355 6623. Portugal Telecom's agent for service of process in the United States is CT Corporation System at 111 Eighth Avenue, New York, New York 10011. Our home page is located at www.telecom.pt. The information on our website is not part of this report. The website address is included as an indicative textual reference only.

We provide telecommunications and multimedia services in Portugal and Brazil. Our service offering covers a full range of:

wireline services, which include fixed line telephone services for retail and wholesale customers, leased lines, interconnection, distribution of programming for TV and radio broadcasters, Internet access, data and business solutions, portal and e-commerce services;

mobile telecommunications services, such as voice, data and Internet-related services;

multimedia services, such as cable and satellite television services and TV programming, film distribution and screening, newspaper publishing and distribution, radio programming and Cable Internet; and

sales of telecommunications equipment.

In Portugal, we are the leading provider of all of these services. The provision of wireline services in Portugal continues to account for a larger proportion of our revenues (37% during 2003) as compared to revenues derived from any other line of business in our group. In Brazil, we have a leading position in the mobile market. To strengthen our position in the Brazilian mobile telecommunications market, we entered into a strategic alliance with Telefónica Móviles, the Spanish telecommunications company, pursuant to which we created, on December 27, 2002, a new mobile telecommunications services company in Brazil, Brasilcel, which was rebranded Vivo on April 8, 2003. See " *Brazilian Mobile Business*", below.

We are focusing our efforts on market segments and businesses that have the potential for high growth, and we are positioning our company as the leading integrated supplier of a full range of telecommunications services in Portugal. We derive an increasing share of our revenues from new services in fast-growing businesses in Portugal, such as mobile services, multimedia and Internet services, and from mobile services in Brazil.

The telecommunications market is increasingly characterized by new opportunities resulting from technological development, the growth in demand for mobile and Internet-related services and the increasing use of information technology in telecommunications services. Our objectives are to:

continue to leverage our experience as the leading provider of wireline, mobile and multimedia services in Portugal;

capitalize on our leading position in the Portuguese market to preserve the profitability and cash flow of our wireline and mobile businesses;

exploit new growth opportunities in service areas, such as multimedia and Internet services in Portugal; and

continue to pursue opportunities for growth in the mobile business in Brazil, through Vivo.

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For information regarding our current and historic principal capital expenditures and divestitures, see "*Item 5 Operating and Financial Review and Prospects Capital Investment and Research and Development*".

Our Businesses

Business Units

Our market is characterized by increasing competition and rapid technological change. In 1999, the board of directors of Portugal Telecom adopted a plan to reorganize the company to better position it in this competitive market. As part of our reorganization, Portugal Telecom changed its name and corporate purpose from Portugal Telecom, S.A., a telecommunications operating company, to Portugal Telecom, SGPS, S.A., a group holding company, and we aligned our subsidiaries according to business lines. Portugal Telecom's business unit subsidiaries are held by Portugal Telecom in its role as holding company. We have integrated different functions across the board, with particular emphasis on information systems (PT Sistemas de Informação), research and development capabilities (PT Inovação), back office activities (PT Pro), central purchasing capabilities (PT Compras) and call center operations (PT Contact). In addition, in April 2004 we created Portugal Telecom Investimentos Internacionais Consultoria Internacional, S.A. to manage all of our international businesses. See "*Item 5 Operating and Financial Review and Prospects Overview Our Business Reorganization and Revenue Reporting Categories*".

The diagram below presents our different businesses, taking into account the internal reorganization we initiated during 2003 and completed in the first quarter of 2004.

-
- (1) Providing wireline services in Portugal, including our fixed telephone service, Internet access services, wholesale services and data and business solutions services.
 - (2) In our discussion of this business segment below, we have provided a diagram of the organizational structure of Vivo.
 - (3) Providing multimedia services in Portugal, including cable operations through TV Cabo, audiovisuals services through Lusomundo Audiovisuals and Lusomundo Cinemas, and media services through Lusomundo Media. In our discussion of this business segment below, we have provided a diagram of the different businesses operating under PT Multimédia Serviços de Telecomunicações e Multimédia, SGPS, S.A., or PT Multimedia.
 - (4) Various international investments, including global telecommunications operators in Cabo Verde Islands and Macau, mobile operators in Morocco, Angola and Botswana, and other investments in various countries.
 - (5) Various instrumental companies providing services to PT group companies, including PT Sistemas de Informação (information systems), PT Inovação (research and development), PT Pro (shared services), PT Compras (central purchasing) and PT Contact (call centers).

Wireline Business

Our wireline business consists of the three operating companies, PT Comunicações, PT Prime and PTM.com, which are currently managed on an integrated basis, providing the following services on our wireline network:

retail, including fixed line telephone services and Internet access services to residential and small office home office customers;

wholesale, including leased lines, transmission of television and radio signals and interconnection services;

data and corporate, including data communications, leased lines to major clients, network managing and outsourcing; and

other wireline services, including our directories business and sales of telecommunications equipment.

PT Comunicações holds and operates our fixed line network, providing fixed line telephone services, wholesale services, directories and sales of telecommunications equipment. PT Comunicações provides fixed line telephone services pursuant to a Concession granted to us by the Portuguese government and transferred to PT Comunicações pursuant to Decree Law 219/2000. On December 11, 2002, PT Comunicações entered into a definitive agreement to acquire full ownership of the basic telecommunications network from the Portuguese government for €365 million, which included the 2002 Concession rental payment of €16.6 million. Since then, PT Comunicações has owned the basic telecommunications network.

PT Prime offers corporate customers in Portugal data and corporate services through a "one-stop-shop" for a variety of flexible, efficient and innovative solutions using information technology, telecommunications, Internet and outsourcing. Until October 6, 2003, we held 87.5% of the share capital of PT Prime. SIBS, a Portuguese entity operating the ATM network and the inter-bank payment system in Portugal, held the remaining 12.5%. On July 20, 2003, we signed an agreement with SIBS for the acquisition of its 12.5% stake in PT Prime for €39 million, which was completed on October 6, 2003.

PTM.com is the leading Internet company in Portugal, operating as an Internet access service provider using our fixed line network and in portal and related activities through sapo.pt, Portugal's leading Internet portal. PTM.com was formed in March 2000 by PT Multimedia to aggregate all of its Internet activities focused on the residential and small and medium size enterprise markets. On October 17, 2002, we entered into an agreement with PT Multimedia to acquire its 100% interest in PTM.com. The sale of PT Multimedia's Internet business to us was intended to encourage the continued growth of our broadband businesses and increase the loyalty of fixed line subscribers, while providing a single platform for investment and development of on-line services and content for the Portugal Telecom group. The results from our services provided through PTM.com have been included in our wireline business segment since 2003. We have adjusted our results for prior years to include PTM.com's results in our wireline business segment, as opposed to our PT Multimedia business segment. See "*Item 5 Operating and Financial Review and Prospects Overview Our Business Reorganization and Reporting Categories*".

Fixed Line Network. We, through PT Comunicações and PTM.com, maintained approximately 4.2 million main lines in service at December 31, 2003, excluding external supplementary lines, direct extensions and active multiple numbers. We break our fixed line network down into traditional main lines (PSTN), ISDN lines and ADSL lines. Because of their large capacity, we count ISDN lines, which transmit voice and data at higher rates than analog lines, as equivalent to either two or up to 30 (depending on whether they are basic or primary ISDN lines) traditional main lines. Using this

counting convention, total main lines included approximately 812,530 equivalent ISDN lines. We offer high-speed Internet access through ADSL lines. As of December 31, 2003, we had 188 thousand ADSL lines, of which 161 were attributable to our ADSL retail business (which is operated by PTM.com), and 4,037 PSTN/ISDN lines, of which 79.2% were residential/small office home office clients, 15.2% business and the remainder mainly payphones, wholesale lines and other.

The following table shows the number of our main lines by category.

	As of December 31,				
	1999	2000	2001	2002	2003
Fixed line main lines in service (thousands)					
Traditional main lines	3,753	3,650	3,501	3,317	3,224
ISDN main line equivalents	477	653	800	826	813
ADSL	0	0	3	53	188
Total	4,230	4,303	4,304	4,196	4,225
PSTN/ISDN fixed line main lines per 100 inhabitants	41.5	41.9	42.3	41.9	41.2
Public pay phones (thousands)	42.5	44.6	45.5	43.8	41.4

Over past years, PT Comunicações has made significant investments to meet subscriber demand for lines and to modernize our fixed line network. As a result, the number of PSTN/ISDN lines per 100 inhabitants almost doubled from 20.9 fixed line main lines at the end of 1989 to approximately 41.2 fixed line main lines at the end of 2003.

In September 1999, the number of active mobile cards (the mobile equivalent of main lines) overtook the number of fixed line main lines in Portugal, and traffic that once was transmitted in whole or in part on our fixed line network is being carried on our mobile network or on the network of other mobile operators. We are addressing this trend by encouraging increased use of our fixed line network for other data services.

During 2003, PT Comunicações focused its attention on attracting new wireline customers through a campaign entitled "Rediscover the Fixed Business". PT Comunicações offered its wireline customers a large portfolio of modern and innovative products and services.

All of our local switches in Portugal have been digital since 1999. Digital technology is used on all long distance and trunk connections. This level of digitalization of our fixed line network permits us to market and provide network-based value-added services, such as call waiting, call forwarding and voice mail, resulting in increased line usage. By the end of December 2003, PT Comunicações was providing approximately 1,042,713 voicemail boxes.

Our fixed line network includes ISDN lines, which transmit voice and data at higher rates than analog lines. We, through PT Comunicações, have offered ISDN services commercially since 1994. PT Comunicações offers a basic-rate service, which provides two communications channels. It also offers a primary-rate service which provides up to 30 communications channels. At the end of December 2003, PT Comunicações had 272,700 subscribers to the basic-rate ISDN service and 8,973 subscribers to the primary-rate ISDN service.

The following chart sets forth the number of ISDN equivalent main lines at the end of each of the last five years:

ISDN Lines

By the end of 2003, ISDN lines represented 20.1% our total equivalent fixed line main lines, as compared with 19.9% one year before. The conversion of traditional main lines to ISDN lines results in increased quality of service, and PT Comunicações' ISDN subscribers tend to produce higher levels of usage per line than traditional main line subscribers.

We, through PT Comunicações, have started to deploy higher-speed ADSL lines. PT Comunicações launched ADSL service on a wholesale basis in Lisbon and Oporto in 2002, covering 98.9% and 99.2% of those cities, respectively. Throughout the remainder of 2002, ADSL services were made available in the rest of Portugal, increasing total coverage throughout Portugal to 84.7% at the end of 2003. In addition, through PTM.com we launched a plug & play solution ADSL service in the third quarter of 2002, targeting residential customers, and a tailor-made service developed for small office home office and small and medium-sized enterprise customers.

PT Comunicações had 0.2 billing complaints per 1,000 bills and 10.1 reported faults per 100 main lines in the year ended December 31, 2003. The percentage of faults repaired in less than 12 working hours was 74.5% in the year ended December 31, 2003, compared with 88.1% in 2002. PT Comunicações offers residential customers detailed billing on request without extra charge.

Traffic. During the five-year period from 1999 through 2003, total traffic originating on the network increased by an average of 0.3% per year, although 2002 was the first year in which it

decreased. The chart below sets forth the rate of growth or decrease of traffic originated on our fixed line network.

Total Growth of Originated Traffic

The following table shows the breakdown of fixed line traffic originated on our fixed line network among mobile, Internet and data and other domestic and international traffic for the periods indicated.

Year ended December 31,

	1999		2000		2001		2002		2003	
	Millions of minutes	(%)	Millions of minutes	(%)	Millions of minutes	(%)	Millions of minutes	(%)	Millions of minutes	(%)
Domestic	9,972	69.4	8,933	53.7	7,431	43.0	6,480	39.6	5,841	40.1
International	410	2.8	413	2.5	411	2.4	402	2.5	382	2.6
Fixed-to-Mobile	1,083	7.5	1,290	7.8	1,215	7.0	1,119	6.8	1,023	7.0
Internet	2,800	19.5	5,630	33.8	6,920	40.0	6,581	40.3	5,023	34.5
Other	114	0.8	379	2.2	1,319	7.6	1,758	10.8	2,294	15.8
Total	14,379	100.0	16,645	100.0	17,296	100.0	16,340	100.0	14,563	100.0

During 2003, Internet-related traffic accounted for approximately 34% of the total traffic originated on the fixed line network compared with 40% during 2002. According to an administrative decision by ANACOM, the Portuguese telecommunications regulator, of February 21, 2001, PT Comunicações changed its billing structure for Internet service. This billing regime accommodates two different types of billing arrangements. Under the first method, ISPs pay a call origination charge to PT Comunicações, and, if the ISPs request that PT Comunicações invoice customers on their behalf, they pay PT Comunicações the correspondent invoicing charge. Under the second method of billing, PT Comunicações charges the ISPs a wholesale flat rate and the ISPs bill their own customers. On March 16, 2004, ANACOM issued a new administrative decision regarding the billing structure for Internet service. As a result, the billing arrangements between PT Comunicações and ISPs are now ruled by two different billing regimes. The primary differences between the two billing regimes relate to origination prices, the manner in which ISP infrastructures are connected to PT Comunicações' wireline network and billing arrangements. The regime introduced in March 2004 has lower origination charges, involves the use of leased lines and does not require PT Comunicações to maintain billing arrangements with ISPs. The ISPs determine which billing regime will apply to their billing arrangements with PT Comunicações. For additional information, see "Regulation Interconnection Internet Access" and "Item 5 Operating and Financial Review and Prospects Overview Internet Interconnection Charges".

PT Comunicações is required to provide carrier selection to its customers on all kinds of traffic. See " *Regulation Portugal Number Portability and Carrier Selection*". Carrier selection, excluding non-geographical services, such as number translation services, has not yet resulted in large-scale reduction in its traffic.

Except for customer pre-selection and Internet traffic, PT Comunicações accounts for traffic originating on our network in its fixed line telephone services unit. Traffic originating on other networks but terminating on our network is allocated to its wholesale unit. Until the fourth quarter of 2000, PT Comunicações did not own traffic that originated on its network and terminated on mobile networks. It collected the revenues for such traffic and transferred them to the mobile network operators which then repaid PT Comunicações the amount allocable to the fixed line portion of the call under its interconnection agreements. This repayment was accounted for by PT Comunicações as wholesale revenues. Since October 1, 2000, PT Comunicações owns this traffic. As a result, PT Comunicações bills its customers for fixed-to-mobile traffic, while mobile operators charge PT Comunicações for call termination. PT Comunicações allocates the revenue billed to customers to its fixed line telephone retail service revenue. As a result of this change, PT Comunicações' absolute margins have not changed, but its percentage margins decreased. See " *Wholesale Traffic*", below.

Marketing. Our wireline business, through PT Comunicações, is increasing marketing efforts towards customer loyalty and promoting increased usage of our wireline telephone services.

Promotional Efforts and Market Analysis. PT Comunicações has increased its promotional and marketing campaigns. It wants the public, and particularly its customers, to recognize that it provides better service and more attractive billing packages than its competitors. PT Comunicações is aggressively promoting the sale of products and services targeted to specific customers, in line with its "resegmentation of customers" policy implemented in 2003, through:

the promotion of a special pricing package named "PT Preços para Si" addressed both to the residential and business markets, which sold more than 550,000 packages since its launch in April 2003 through the end of 2003, exceeding expectations;

the launch of a campaign to exchange old equipment for updated equipment, allowing access to new facilities and increasing traffic;

the launch of "ADSL network PT" to wholesale ISPs. During 2003, total ADSL lines grew 257% and represented 4.7% of PT Comunicações' fixed line main lines, compared to 1.3% in 2002; and

the launch and promotion of innovative products and services and special pricing packages, such as "SMS for fixed network", "Concept Juris" designed for lawyers, "Concept Hotel" providing high-speed Internet access to hotel customers, and "Concept Business", "PT 1a Vez", "Portugal 15", "Night and Week End", "Hello Card PT" and "Telecom Card PT" addressed both to the residential and business markets and designed to promote domestic and international traffic.

Internet customers can also profit from special programs created by PT Comunicações that provide special conditions for access and use of PT Comunicações' network. PT Comunicações also sells higher-speed Internet access, including ADSL services, to take advantage of the growing use of Internet services in Portugal and of the group's various Internet-related services.

PT Comunicações uses market research programs to evaluate customer satisfaction and service quality and to help develop products. PT Comunicações focuses its marketing on different segments of its residential and business market. It has a state-of-the-art billing and customer information system and a marketing information database that combines usage and other data.

Targeted Subscriber Packages. PT Comunicações has targeted its products and pricing packages to specific segments of the retail market, such as family groups and small and medium-sized enterprises.

Customer Care. To provide support and marketing services to its residential and business customers, PT Comunicações has developed a network of regional organizations and retail service centers. In addition, it has separate call centers dedicated to increasing services to its residential and business customers. The call centers are interconnected and cover the whole country. This system allows PT Comunicações' customer service representatives to access the history of customers' telephone use and commercial dealings with PT Comunicações.

Increased Selling Efforts. PT Comunicações has developed its distribution network through its retail service centers and agents such as supermarkets and other retail outlets. Its customer support system enables it to develop strategies to sell new and expanded services to its customers. In addition, PT Comunicações is expanding its telemarketing activities, addressing both residential and small and medium-sized enterprise marketing segments and developing more proactive and closer relationships with its customers.

Retail

Fixed Line Telephone Services. Our group's largest business is providing public fixed line telephone services in Portugal to retail customers, primarily through our subsidiary PT Comunicações. This business area provided €1,324.4 million, €1,411.6 million and €1,624.7 million to our consolidated operating revenues during 2003, 2002, and 2001, respectively. We distinguish between two principal sources of revenue in the provision of fixed telephone services:

Fixed charges, including network access charges based on a monthly line rental and an initial installation fee; and

Traffic, including charges for the use of our fixed line network based on rates dependent on amount and type of usage.

We divide traffic into domestic and international traffic. Domestic traffic includes domestic telephone services provided by PT Comunicações directly to subscribers that originate or terminate calls on our fixed line network. International traffic includes international telephone services provided by PT Comunicações directly to users that originate calls on our fixed line network.

Since January 1, 2000, public switched fixed line telephone services in Portugal have been fully open to competition. As a result of the introduction of competition, combined with the substitution of mobile for fixed-line services, we have experienced, and may continue to experience, increased erosion of market share of both access lines and of outgoing domestic and international traffic. See "*Competition Competition Facing Our Wireline Business*".

Fixed Charges. PT Comunicações' fixed charges to domestic fixed line telephone subscribers include a one-time installation charge and a monthly line rental fee. These fixed charges provided €647.5 million, €629.1 million and €638.7 million to our consolidated operating revenues during 2003, 2002, and 2001, respectively.

As of December 31, 2003, the installation charge to our subscribers was €71.83. The standard line rental fee is €12.3 per month for standard lines and €24.5 per month for ISDN basic lines, in each case excluding value-added tax.

The chart below illustrates changes in PT Comunicações' prices and fees from 1999 through 2003. All prices are in Euros and exclude VAT.

Fixed Fees for Fixed Line Telephone Services(1)

	As at December 31,				
	1999	2000(2)	2001	2002	2003
Installation fee	79.94	77.69	74.41	71.83	71.83
Line rental per month	11.66	12.08	12.27	11.85	12.3

(1)

Amounts rounded to nearest hundredth.

Traffic. Traffic contributed €676.9 million, €782.5 million and €986.0 million to our consolidated operating revenues during 2003, 2002, and 2001, respectively. Measured in minutes, total fixed line retail traffic originating on our fixed line network decreased by 3.5% during 2003, compared with 2002. The decrease was primarily due to the effects of mobile substitution, the migration of heavy dial-up Internet users to ADSL and a more challenging economic environment.

Domestic. PT Comunicações estimates that domestic traffic generated operating revenues of €570.5 million in 2003, €662.7 million in 2002 and €862.8 million in 2001.

Prices In 1999, PT Comunicações' charging system for traffic was based on a fixed line price pulse. On January 1, 2000, PT Comunicações introduced a system for charging its customers on a per-second basis, after a time credit included in the initial call price. PT Comunicações has three domestic tariffs: local, regional and national. Between the end of 1999 and the end of 2003, weighted average prices for domestic fixed line telephone services decreased by 1.9% per year in nominal terms. Compared with 2002, over the course of 2003, domestic prices decreased a further 0.27% in nominal and annual terms. See " *Regulation Portugal Pricing of Wireline Services*".

The chart below illustrates changes in PT Comunicações' prices from 1999 through 2003. The call prices from 1999 through 2003 are for a three-minute call at peak rates in 2003 constant prices. All prices are in Euros and exclude VAT.

Principal Prices for Domestic Fixed Line Telephone Services(1)

	As at December 31,				
	1999	2000(2)	2001	2002	2003
Local call prices	0.10	0.13	0.12	0.12	0.12
Regional call prices	0.31	0.31	0.24	0.23	0.21
National call prices	0.66	0.42	0.35	0.33	0.29

(1)

Amounts rounded to nearest hundredth.

(2)

For a three-minute call the prices are greater in 2000 than in 1999 due to per-second pricing introduced in 2000.

Prices for local, regional and national calls did not change in 2003. The average annual reduction in 2003 for the basket of prices was about 1.2% in nominal terms. PT Comunicações' pricing structure has come more into line with pricing structures in the rest of the EU over the last nine years. The following table compares our estimates of average domestic services prices per minute, excluding VAT,

for a three-minute call at peak rates in the EU with average prices in Portugal in effect at December 31, 2003.

Principal Prices for Domestic Fixed Line Telephone Services: EU and Portugal

	As of December 31, 2003	
	EU Average	Portugal
Local call prices	0.12	0.12
Regional call prices	0.18	0.21
National call prices	0.21	0.29

To increase its price competitiveness, PT Comunicações is promoting innovative differentiated pricing plans for market segments. For example, it offers various plans specially designed for business customers as well as other plans for residential customers. PT Comunicações also offers a prepaid card and pricing plans suited for Internet users, as well as plans aimed at the development of education and the information society.

International. PT Comunicações estimates that operating revenues from international fixed line telephone services were €106.5 million in 2003 compared with €119.8 million in 2002 and €123.2 million in 2001. Revenues from international fixed line telephone services come primarily from charges to its individual and business subscribers in Portugal for outgoing calls. PT Comunicações must pay a portion of these charges to other international operators whose facilities carry the calls. In 2003, 2002 and in 2001, PT Comunicações' revenues from international fixed line telephone services decreased while international traffic continued to grow. This decrease in revenues resulted from decreases in international accounting rates and decreases in prices for outgoing international calls. PT Comunicações expects these decreases to continue.

Accounting Rates Historically, the amount of incoming traffic has been significantly greater than the amount of outgoing traffic. As a result of this imbalance, PT Comunicações receives higher payments from other international telecommunications operators than it pays out to these operators. PT Comunicações negotiates the amount of the payments with these operators periodically.

In recent years, the accounting rates among operators have been declining steadily, both for incoming and outgoing traffic. PT Comunicações estimates, however, that, on an aggregate basis in Euros, termination rates for international traffic at the end of 2003 decreased by a weighted average of approximately 9% for incoming traffic and decreased by 10% for outgoing traffic as compared to the end of 2002.

With the opening of the Portuguese market to competition on January 1, 2000, international telecommunications operators are now able to provide services directly in Portugal. They can lease lines from PT Comunicações or obtain international lines from other operators and then interconnect with our fixed line network. The revenues PT Comunicações receives from such services are interconnection fees and thus fall into the wholesale business category of our wireline business. As a result, while PT Comunicações' share of the international market has declined, increases in our wholesale business have, to a substantial extent, offset this decline.

Prices PT Comunicações sets traffic charges for international fixed line telephone services in a number of different groups of countries. Within each group, it charges different prices according to the time of day and the day of the week that the customer makes the call.

Between the end of 1999 and the end of 2003, PT Comunicações experienced aggregate reductions in real terms of 39% in international traffic. These included an average reduction in nominal terms of 3.4% for international calls over the course of 2003.

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The table below shows changes in prices for our international fixed line telephone services to selected destinations since 1999. The prices for 1999 through 2003 are peak rate prices per minute on the basis of a three minute call, set at 2002 constant prices. They are in Euros and exclude VAT.

Selected Prices for the International Services(1)

	As of December 31,				
	1999	2000	2001	2002	2003
EU(2)	0.38	0.29	0.28	0.27	0.27
Other European countries(3)	0.70	0.67	0.63	0.61	0.61
United States	0.38	0.30	0.29	0.28	0.28
Canada	0.39	0.30	0.29	0.28	0.28
Brazil	0.70	0.67	0.59	0.57	0.57

- (1) Euro amounts rounded to nearest hundredth.
- (2) Including Switzerland.
- (3) Excluding Norway and Iceland.

ADSL Services and ISPs. Through Telepac, PTM.com's ISP, PTM.com is the leader in providing Internet access in Portugal. By December 31, 2003, Telepac had approximately 1.5 million access subscribers in Portugal. This was an overall increase of 59% over one year before. We estimate that 30% of Portuguese Internet traffic in minutes was connected through Telepac during 2003. Telepac offers dial-up paid and free Internet access services. We estimate that altogether Telepac provided Internet access to about 20% of the Portuguese subscriber market at December 31, 2003. The number of hours of subscriber use in 2003 decreased by 30% to 23 million hours compared to 33 million hours in 2002, reflecting the increasing penetration of broadband, soft cable and ADSL in Portugal.

Application Service Provider (ASP). Telepac also provides ASP services in Portugal. These activities include remote applications services, web hosting and web design services to small and medium-sized enterprises. Telepac had approximately 3,072 thousand customers for its ASP business at December 31, 2003.

ISP Traffic Revenues. PTM.com provides its Internet services in cooperation with our other companies in the Portugal Telecom group. It offers Internet access through the lines of our fixed line network. Until June 1, 2001, in accordance with regulation of ANACOM, PTM.com recovered 35% of the revenues from the fixed line traffic from PT Comunicações, which retained 65% of such revenues. From September 2001, PTM.com retains all of the revenues from Internet traffic and pays PT Comunicações for use of the fixed line network. See "Item 5 Operating and Financial Review and Prospects Overview Internet Interconnection Charges".

Wholesale

Our wireline business' wholesale services, which are provided primarily through PT Comunicações, consist of:

domestic and international interconnection telephone services that we provide to other telecommunications service providers in Portugal, including other companies in our group;

leasing of Portuguese and international lines to other telecommunications service providers and Portuguese cable television operators, including other companies in our group;

transmission of television and radio signals for major broadcast television companies in Portugal; and

Internet interconnection services, which we began to provide to ISPs in Portugal in June 2001.

Consolidated operating revenues from wholesale services provided to companies outside our group were €315.1 million in 2003, €371.5 million in 2002 and €356.2 million in 2001.

Traffic. Interconnection traffic comprises about 58.8% of our wholesale business in terms of revenues. The service providers who purchase interconnection services include mobile telephone network operators, data communications providers, Internet service providers, value-added service providers and service providers whose international calls are terminated on or carried by PT Comunicações. Providing interconnection services means allowing third parties to connect their networks to our network, and vice versa. This interconnection is necessary, for example, to allow calls or data signals that originate on another network to terminate on our network, and vice versa. Since the introduction of full competition into the Portuguese telecommunications market on January 1, 2000, we, through PT Comunicações, have begun to provide interconnection telephone services to 11 other operators of public switched voice telephone networks, although traffic volume has been low. PT Comunicações has interconnection rates for call termination, call origination, transits and international interconnection. At this time, interconnection rates per minute for call termination include local transit rates equal to €0.775, single transit rates equal to €1.115 and double transit rates equal to €1.409, each based on a three-minute call made during peak hours. PT Comunicações also classifies value-added services, including audio text services, on an interconnection basis. PT Comunicações published the latest version of its reference offer for unbundled access to our local loops on September 15, 2003, and since then has made available to its competitors, where technical and space conditions are available, all of the local switches, 59 of which are co-located. See "*Regulation Portugal Unbundling of the Local Loop*" and "*Regulation Portugal Number Portability and Carrier Selection*".

On February 21, 2001, ANACOM issued an administrative decision instructing PT Comunicações to submit a reference Internet access offer proposal changing its billing structure for the connection of ISPs to our fixed line network from a model based on revenue sharing to one based on call origination charges and establishing maximum prices that PT Comunicações is permitted to charge ISPs for Internet access service. PT Comunicações published such a proposal on March 1, 2001. As discussed below in "*Item 8 Financial Information Legal Proceedings*," PT Comunicações has submitted a claim to the Lisbon administrative court requesting relief from this decision and contesting its legality. See also "*Regulation Portugal Interconnection Internet Access*".

Wholesale services traffic is generated by the interconnection portion of our wholesale business. Its revenues from leased lines and television signal transmission do not depend on traffic levels. Domestic traffic generated by our wireline business' wholesale interconnection services decreased by 12.9% in 2003 compared with 2002. This decrease was primarily due to a decrease in Internet traffic, which was partially compensated for by increases in indirect access traffic. The following table sets forth the total

amount of wholesale services domestic traffic on our fixed line network during the period 1999 through 2003.

**Wholesale Services Domestic Traffic
(millions of minutes)**

	Year ended December 31,				
	1999	2000	2001	2002	2003
Mobile	1,192	1,172	1,061	998	959
Internet	2,800	5,630	6,916	6,581	5,023
International	N/A	1,138	1,343	1,420	1,318
Other	114	594	2,336	2,831	3,008
Total	4,106	8,534	11,656	11,830	10,308

The traffic figures for mobile include fixed-to-mobile, mobile-to-fixed and mobile-to-mobile traffic between different networks. Since October 1, 2000, fixed-to-mobile traffic has been allocated to PT Comunicações' fixed line telephone services revenues instead of PT Comunicações' wholesale business revenues. The data presented for previous years was adjusted in accordance with this allocation. See "Retail Fixed Line Telephone Services Traffic", above.

We estimate that international wholesale mobile traffic accounted for approximately 46.2% of the Portugal Telecom group's total outgoing international traffic and approximately 36.4% of total incoming international traffic in 2003. We estimate that, in 2002, these percentages were approximately 43% and 37%, respectively.

Leased Lines. We, through PT Comunicações, lease lines to other telecommunications providers for mobile and data communications services, including our other subsidiaries and competitors. Since 1996, PT Comunicações has leased lines to resellers who offer voice services to corporate networks and closed user groups. Leased line services involve making a permanent point-to-point connection for voice and data traffic between two geographically separate points.

PT Comunicações' Concession requires it to provide leased lines to third parties. ANACOM defined a minimum set of leased lines as including 2-wire and 4-wire traditional lines and 64 kbit/s to 34 Mbit/s digital lines. PT Comunicações is also providing higher capacity 140 Mbit/s and above digital lines to third parties in Portugal.

The three current mobile telephone operators in Portugal, which include our subsidiary TMN, Vodafone Portugal and Optimus, are among our wireline business' largest leased line customers. PT Comunicações leases lines to TMN and TV Cabo on a basis that does not discriminate against other customers.

Prices. The net prices and fees PT Comunicações receives from providing access to our fixed line network on a wholesale basis are less per minute than those it charges for domestic and international fixed line telephone services. PT Comunicações has entered into a variety of different pricing arrangements for providing access to our fixed line network. PT Comunicações usually negotiates the amount of these prices with the service provider. The prices usually include a negotiated volume-based discount.

Domestic interconnection revenue per minute for calls terminated on our network declined by 19% in nominal terms in 2003 compared with 2002. International interconnection revenue per minute declined by 9% in nominal terms in 2003 compared with 2002. In accordance with EU and Portuguese regulation, PT Comunicações' interconnection prices are cost-oriented and non-discriminatory.

Since December 31, 2000, there have been no restrictions on leased line pricing, and PT Comunicações is able to negotiate freely prices for leased lines. See " *Regulation Portugal Pricing of Wireline Services*". PT Comunicações does not discriminate on prices between retail customers and customers that provide services to other providers, such as data network service providers and Internet service providers, although we do offer discounts according to the usage of the customer.

Data and Corporate

Our data and corporate services, within our wireline business, are provided by PT Prime to corporate customers that have a need for complex telecommunications solutions, with a focus on the top 6,500 companies in Portugal. It offers those customers data and business solutions, such as:

low speed data communications

digital leased lines

broadband data

networking and systems integration solutions

Internet-related services and applications including Intranet and Extranet services

interactive systems and related applications

outsourcing of telecommunications application systems

consultancy services

Web design and site management

fixed line and mobile convergence services

business-to-business e-commerce

housing and hosting solutions, including application service provider, or ASP, and enterprise resource planning, or ERP

telephone services using Internet protocol

PT Prime is the leading supplier of the full range of these services in Portugal. Data and corporate operating revenues amounted to €226.7 million in 2003, €225.9 million in 2002 and €201.7 million in 2001.

Services. PT Prime is one of the focal points for our group's interface with business customers in Portugal for our data, Internet, fixed line and mobile services. PT Prime has developed a full range of telecommunications services, and it integrates these services, as well as other services within the group, such as fixed line services and domestic mobile services, to provide its customers with packaged groups of services. In addition, PT Prime has its own license to provide a full range of telecommunications and related services in Portugal. By combining its communications capabilities with its software-based integrated systems and applications, PT Prime can offer integrated voice, data and image solutions, virtual private networks, convergence solutions, consultancy and outsourcing on a single commercial interface. We believe that PT Prime is the main service provider in Portugal capable of offering customers a full range of integrated and customized services rather than stand-alone services. Despite increasing competition, overall demand for data and corporate services has been increasing. As a result of competition, PT Prime has reduced its prices for leased lines and data services.

PT Prime is able to respond to the changing needs of its customers as quickly as new entrants in the Portuguese market do and to pursue and form strategic partnerships to take advantage of opportunities in domestic and international markets. It offers its services in partnership with leading operators and service providers such as British Telecom, Telefónica, Equant and Infonet. It uses systems and networks in partnership with Siemens, Alcatel, Cisco Systems, Newbridge, Motorola, Nortel Networks, Matra/EADS Telecom and IBM.

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PT Prime leases lines and broadband capacity to large businesses for data communications and other private uses and provides related services. It also provides integrated voice and data services to corporate customers. It offers X.25/X.32 synchronous services and X.28 asynchronous services and other switched and non-switched data communications services, such as frame relay, virtual private networks over IP for data communications, broadband services, security/firewall services and VSAT satellite communications services. In addition, it offers a new range of data, voice and Internet services,

such as Intranet, Extranet and managed services, including "voice over IP". It is using IP-based solutions to improve interconnections between companies and their employees and between customers and commercial partners through remote access, and exploring virtual private network capabilities. These solutions enable customers to integrate voice, video and data services in a flexible cost-effective manner with add-on capacity. The offering of web contact centers solutions represents an evolution of the classic call center for customers.

PT Prime provides a range of broadband solutions. The type of solution depends on the type (voice, data or image), volume, priority level and stability of information flow required by its customers.

PT Prime also provides reporting services targeted to special customers to control service level agreements and the overall performance of the network.

In addition, PT Prime is outsourcing corporate networks and services for our group's customers. For example, PT Prime operates and manages the SIBS network as well as the corporate networks of its strategic partners, Caixa Geral de Depósitos and Banco Espírito Santo. Consequently, PT Prime has developed substantial experience structuring and managing the network infrastructures of major Portuguese financial institutions. PT Prime delivers international seamless services aimed at multinational customers in association with Telefónica, British Telecom, Infonet and Equant.

PT Prime has entered into a partnership with Casa da Moeda, CTT and SIBS to create a company called Multicert, with PT Prime, Casa da Moeda and CTT each holding a 20% stake and SIBS holding the remaining 40%, which intends to provide digital certificates and communications security services to both consumer and business segments.

Networks. PT Prime network services use their own switched and access points in customer premises and their own network and lines leased from our fixed line network. PT Prime provides its services over the largest IP backbone in Portugal, leasing the necessary fixed line capacity from PT Comunicações. It has points of presence in all major cities throughout Portugal. This broadband data transmission network provides high capacity, flexibility and security. It can progressively incorporate current voice and data infrastructures at lower costs than alternative networks. PT Prime also provides high speed Internet access through asymmetric digital subscriber lines, known as ADSL. The ADSL lines are linked to digital subscriber line access multiplexes, or DSLAMs, located at fixed line network switching centers. PT Prime leases the necessary fixed line capacity from PT Comunicações. PT Prime supplies full IP and broadband connectivity for our whole group.

Revenues from services that offer leased lines of PT Comunicações are typically divided between PT Prime's own direct billings to its customers and our leased line revenues from our wholesale business. Revenues from our group's fixed line voice services for corporate customers are not reflected directly in PT Prime's revenues. PT Prime obtains fixed line voice services from PT Comunicações. Because PT Prime is integrating the services of other companies in the group, such as PT Comunicações and TMN, it receives agency fees for arranging and selling these services which are cancelled out in the group's financial consolidation process. In 2003, these agency fees amounted to approximately €8.8 million.

Systems Integration. PT Prime offers an integrated range of telecommunications and information technology services to the business market. PT Prime's goal is to service all of its customers' telecommunications needs and to leverage the traditional offering of products and services from our group.

PT Prime has a strong and competitive position in the development of information technology solutions where communications are an integral part of the services provided. To reinforce its position as a leader in this area, PT Prime is pursuing a partnership strategy with the main information technology suppliers in the market, particularly software and hardware providers. PT Prime is also

exploring synergies arising from its relationship with our subsidiary PT Sistemas de Informação, the information technology arm of our group.

To support these new services and to respond to the increasing demand of e-business integrators, PT Prime developed a corporate Internet Data Center. This facility allows it to provide services, such as co-location, sophisticated web hosting, ISP services, data storage and ASP services. To develop, build up and manage the Internet Data Center, PT Prime has selected IBM Global Services, the world leader in this market segment, as its partner. Pursuant to the terms of an agreement between PT Prime and IBM, the Corporate Internet Data Center began to provide Internet hosting services for corporate customers in April 2001.

PT Prime also offers services focused on the integrated management of networks ranging from local area networks, or LANs, to software applications, including PC management.

Marketing and Customer Care. PT Prime is focusing significant resources on marketing and customer care. Over 300 of PT Prime's 509 employees are involved in marketing services directly to business customers. Account managers are being given clear incentives to meet and exceed sales targets. PT Prime is upgrading its sophisticated customer relationship management platform, or CRM, to increase focus on market and Internet efficiency.

PT Prime is seeking to compete in Portugal on the basis of the quality of its services as well as its position as the leading supplier of integrated telecommunications and IT services. PT Prime is pricing its various service offerings on the basis of the volume of traffic, the duration of service agreements and the scope of the services offered to each customer.

PT Prime offers its customers services available from other companies in our group. Our subsidiary PTM.com, for example, provides significant support for product development and the marketing of Internet access and web hosting services for small and medium-sized enterprises. PT Prime offers mobile telephone services options for corporate accounts while our subsidiary TMN also maintains its own direct relationships with this important customer segment.

PT Prime uses customer care capabilities that were developed for PT Comunicações. To maximize customer loyalty, PT Prime is developing systems that provide integrated assessments of customer profiles, based on a CRM system. We believe that to reinforce its competitiveness, PT Prime must change and optimize its processes and focus the entire organization on its customers more effectively.

Other Wireline Services

Other wireline services include primarily our directories business and sales of telecommunications equipment.

Directories. Operating revenues from our directories business amounted to €136.1 million in 2003, €139.1 million in 2002 and €136.8 million in 2001. We subcontract to Páginas Amarelas (an associated company 25% owned by us) for the publication and distribution of telephone directories throughout Portugal in return for an annual payment of approximately 64% of its gross revenues from the sale of advertising space. Currently, the provision of yellow page directory services is not subject to significant competition.

Sales of Telecommunications Equipment. Revenues from sales of telecommunications equipment amounted to €36.8 million in 2003, €34.8 million in 2002 and €43.0 million in 2001, including the sale of handsets, modems and other telecommunications equipment.

Domestic Mobile Business

TMN, our Portuguese mobile operating company, is the leading provider of mobile voice, data and Internet services in Portugal in terms of the number of active mobile telephone cards connected to its network and by revenues, margins and profits.

Operating revenues from TMN amounted to €1,346.7 million in 2003, €1,266.6 million in 2002, and €1,171.9 million in 2001. Mobile services have undergone extraordinary growth in recent years in Portugal. At December 31, 2003, there were approximately 89.8 active mobile telephone cards per 100 Portuguese inhabitants. This was more than the number of wireline main lines per 100 Portuguese inhabitants at December 31, 2003, which was 40.3, according to ANACOM.

The table below provides statistical information relating to TMN.

	As of December 31,				
	1999	2000	2001	2002	2003
TMN Portugal					
Number of subscribers (thousands)	2,115	2,939	3,905	4,426	4,887
Subscribers growth per annum (%)	48	39	33	13	10
Number of subscribers per 100 inhabitants (including competitors' subscribers)	46.7	65.0	77.2	81.9	89.8
Estimated market share by number of subscribers (%) ⁽¹⁾	45.3	44.1	49.0	51.9	52.3
Churn rate (%) ⁽²⁾	28.3	26.1	23.5	25.3	23.5
Number of employees	930	1,019	1,194	1,192	1,109

(1) Source: ANACOM and TMN.

(2) TMN defines the "churn rate" as the percentage of TMN mobile subscribers that end their use of TMN's mobile services either by terminating their service or by changing their mobile handset and card number without terminating their existing TMN service. Generally, a pre-paid card can receive or send calls for a period of three months after the last recharge, depending upon the pre-paid service. After this period, if the card is not recharged, it can only receive calls for an additional three months. After this second three-month period, provided the pre-paid card receives one paid call over the course of the next month, then the pre-paid card is allowed to receive calls for an additional month. This will continue, as long as the pre-paid card continues to receive at least one paid call a month, for a maximum of six months. Once the card ceases to receive paid calls, or after the end of six months, it becomes non-active.

Services. TMN provides GSM mobile telephone services. GSM is a European and worldwide mobile telephone standard using digital technology. Through roaming agreements, TMN's subscribers can use GSM to make and receive mobile calls throughout Europe and in many other countries.

TMN provides GSM services in the 900 MHZ and 1800 MHZ band spectrums. TMN began to offer GSM 1800 services in May 1998 in addition to the GSM 900 service it already offered. TMN's strategy has been to use GSM 1800 services to offer an increased number of channels in high traffic density areas. Dual-band handsets, which select available channels from each frequency band, enable users to benefit from the wider range of available channels.

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TMN paid spectrum fees in 2001, 2002 and 2003 of €25 million, €29 million and €30 million, respectively, for the use of its 900 MHz and 1800 MHz GSM network.

During 2001, 2002 and 2003, TMN continued to introduce new products and services, such as:

"TMN Multi" and "TMN Familiar", which offer discount packages to groups;

WAP services, including "Bolsa on-line" (providing share price information), together with sapo.pt;

"MyTMN", personalized internet and data services which offer text messaging, WAP and voice-based services that can be customized by each subscriber;

"TMN Empresas", which was launched in the third quarter of 2001 and provides services for corporate customers, such as marketing and technical assistance services, in cooperation with our pme.link.pt portal;

the first SMS InterWorking agreement, an interconnection agreement (February 2002);

"DataXpress", a wireless data compressed transmission service using GPRS technology (April 2002);

opening of the second TMN Megastore, in Oporto, which sells products and services of TMN;

first public demonstration of mobile video telephony service, using a UMTS network (May 2002);

corporate solutions to small office home office customers in partnership with pme.link;

MMS services, or multimedia messages, which combine picture and sound (May 2002);

GPRS roaming service, launched in partnership with Telefónica (April 2002);

"Spik" products, a mobile phone with a competitive package of minutes;

"Roaming Zone", a roaming service package for post paid customers;

"Biz Office", a mobile office service launched in 2003;

"K" services, including "Kolmi", a service whereby prepaid customers may send a free message asking the receiver to call back, and "Karga", a service whereby prepaid customers may transfer credit from their mobile phones to other mobile phones;

"Key user" services, providing on-line phone card management for TMN customers;

"I9-Inove", a multimedia mobile portal that provides faster, cheaper and easier access to a wide range of services and content (June 2003); and

"Pakots SMS", a pre-paid SMS package, and "SMS Express", offering competitive tariffs to customers who have high levels of SMS usage.

TMN is also developing services in wireline to mobile convergence, such as a voicemail service, which allows mobile telephone users to retrieve voicemail messages from their fixed-line telephones through mobile telephone handsets with PT Comunicações. TMN also offers a range of Internet-access and multimedia services, such as Internet access service through WAP mobile handsets. This service, available to every TMN subscriber, including users of all prepaid services, allows subscribers to access the Internet through their handsets. In August 2001, TMN launched the "MyTMN" platform, offering personalized Internet and data services, enriched with content and services supplied by new partners. MyTMN allows users to customize a wide range of WAP, SMS and voice-based services. WAP customers can access webmail, agenda, stock exchange information, location-based services, easy messaging, on-line tickets and chat services. TMN invoices its customers for the use of TMN services

and remits to its partners a percentage of the total fees collected that corresponds to the content and services supplied by such partners.

MyTMN's new range of offerings has introduced new services such as Logos & Ring Tones (also polyphonic), Multimedia Messaging (including the ability to send to customers of other operators), Java Games and My Message 4u (a service that allows customers to personalize the welcome message or other voice messages with music, dedications or jokes). At MyTMN, customers can also create their own MMS Album, with holiday souvenirs, cards and similar items.

We expect data-service usage to grow considerably as customers become increasingly familiar with MyTMN, as service offerings are further expanded and as access speed is increased through the introduction of GPRS. We also expect higher data speeds to improve performance and the attractiveness of the MyTMN package of products, which we expect will result in a higher contribution of data services to overall revenues in the future.

In June 2003, TMN launched the multimedia portal I9-Inove, which optimizes the current capabilities of the GSM-GPRS systems to provide customers with faster, cheaper and easier access to a wide range of services and content, such as Java games; the three national free-to-air TV channels; messaging services; goals from the Portuguese football league in video (which is exclusive to TMN); TV Cabo's programming guide; and the Lusomundo cinema ticketing service, the first m-commerce service in Portugal. As of December 31, 2003, I9-Inove had reached 25,153 TMN customers.

TMN introduced its GPRS system at the end of 2000 in Lisbon and Oporto and launched it at the beginning of October 2001 in all other areas of Portugal. See "*Network and Capital Investment*". GPRS provides higher speed data communications than GSM networks. TMN expects the introduction of GPRS to improve its existing WAP services. In addition, GPRS allows TMN to provide "always on" connection to Internet services. To use this service, subscribers must purchase new mobile handsets that are able to carry GPRS services. TMN's allocation of such handsets has been sufficient to meet demand during the initial roll out of its GPRS service. TMN has made capital expenditures in building out its GPRS system of €10.9 million in 2000, €11.7 million in 2001, €5.5 million in 2002, and €0.3 million in 2003.

At the end of 2000, the Portuguese government opened a tender for four licenses for third generation mobile services, also known as universal mobile telecommunications services, or UMTS. TMN received one of these licenses and paid an up-front fee of €100 million. Licenses were also awarded to Oniway, a new entrant in the Portuguese mobile market, Vodafone Portugal and Optimus. However, subsequent to an agreement with the other three mobile operators in Portugal, including TMN, Oniway decided not to participate in the provision of third generation mobile services and as a result requested that the Portuguese government repeal the license granted to it in December 2000. The Portuguese government granted this request by ministerial order on January 13, 2003. The other three recipients of third generation licenses, including TMN, requested that the additional frequency that had been allocated to Oniway be reallocated to them. This request was granted by a special ministerial order in January 2003. See "*Regulation Portugal Third Generation Mobile Services Licenses*". Under the agreement entered into with Oniway referred to above, TMN, Vodafone Portugal and Optimus agreed to pay Oniway an amount of €33 million each for certain intangibles held by Oniway related to UMTS launch preparations upon the reallocation to them of the frequency that had been allocated to Oniway.

We expect the development of third generation services to require certain additional investments by TMN. TMN made direct investments of €12.4 million in 2001, €38 million in 2002 and €67.2 million in 2003 in building out its third generation network.

ANACOM reviewed the situation regarding the availability of handsets and related software for UMTS services during the third quarter of 2002 and initially postponed the mandatory initiation of third generation services for all holders of UMTS licenses until December 31, 2003. In February 2004,

ANACOM issued a decision requiring the initiation of third generation services in 2004. However, UMTS license holders will not be required to initiate UMTS services commercially until June 30, 2004. On April 19, 2004, TMN became the first mobile operator to launch UMTS in Portugal, with a service that allows customers to make video calls. The 3G handsets function both on GSM/GPRS and UMTS, allowing customers to use all the voice, multimedia and data services already offered by TMN. For data access exclusively, TMN also offers a 3G access card. TMN is providing initial UMTS coverage in Lisbon and Oporto, and plans to extend this coverage progressively to cover the whole of Portugal. We expect to be able to make further decision about the deployment of new services based on commercial grounds as well as on applicable ANACOM requirements.

Subscribers and Traffic. TMN is the market leader in mobile services in Portugal. At December 31, 2003, TMN had approximately 4.9 million subscribers, representing an increase of 10.4% from December 31, 2002. At December 31, 2003, TMN's subscribers represented 52.3% of the total mobile subscribers in Portugal. During 2002 and 2003, TMN also captured a greater proportion of the market increase in terms of net subscriber additions than its competitors, enabling it to maintain its position as the market leader. During 2003, TMN's share of new mobile subscribers (net additions) was 56.7%, according to ANACOM. Over the course of 2003, TMN's churn rate, which means the percentage of TMN mobile subscribers that ended their use of TMN's mobile services either by terminating their service or by changing their mobile handset and card number without terminating their existing TMN service, was 23.5%. TMN's churn rate was 25.3% in 2002.

In addition to the increase in the number of subscribers, mobile usage grew during 2003. TMN's voice traffic in terms of minutes grew by 5.3% to 6,752 billion minutes in 2003, compared to 6,413 billion minutes in 2002. Average monthly usage per subscriber decreased 5.7% to 123.1 minutes in 2003, compared to 130.5 minutes in 2002. Traffic from data transmission, such as SMS and GSM WAP services, increased by 13.5% and decreased by 15.9%, respectively, during 2003 in terms of number of calls. Traffic from GPRS WAP services increased by 1,386% in 2003. There was an average of 25.2 SMS messages per month per user in 2003, 1.7% more than the average of 24.8 SMS messages per month per user in 2002.

Prices and Revenue Breakdown. We believe that mobile services in Portugal are priced lower than the European average and are among the lowest in Europe. Mobile telephone charges are not regulated. Traffic charges, sales of handsets and connection and subscription fees represented approximately 88.3%, 9.1% and 2.6%, respectively, of TMN's revenues in 2003, and approximately 87.4%, 9.6% and 3.0%, respectively, of TMN's revenues in 2002. Since May 2003, monthly subscription fees range from €10.00 to €39.96, excluding VAT. TMN no longer charges an initial connection fee. TMN currently has many different price plans for its mobile telephone services.

Products and Marketing. TMN offers a variety of innovative subscriber-oriented products. It was the first operator in the world to offer pre-paid services. TMN's prepaid and discount products have been popular. We estimate that at the end of 2003, approximately 84.1% of its subscribers were using TMN's prepaid products. TMN has been expanding its subscriber base through increased advertising and the use of its own distribution network. TMN markets its services through more than 1,950 points of sale, including our group's and TMN's sales forces, Portugal Telecom retail shops, TMN shops, supermarket chains and independent dealers. TMN has been trying to encourage the use of mobile services more broadly in the middle and high end of the market and to increase subscriber retention in this market segment. By focusing on the business segment of the market, TMN experienced a 6.7% increase in the number of postpaid subscribers in 2003.

Network and Capital Investment. In recent years, TMN has made significant investments in base stations throughout Portugal for its GSM 900 and GSM 1800 services. As a result of its investments, TMN has a technologically advanced high capacity network that provides extensive coverage across Portugal. As of the end of 2003, TMN's digital network had 3,869 base stations, including 70 base stations added during 2003. These stations covered more than 95% of continental Portugal and 98% of

the Portuguese population. The addition of the GSM 1800 band has substantially increased TMN's network capacity in heavily used areas. By the end of December 2003, TMN had installed GSM 1800 technology in 771 base stations. TMN has offered GPRS services, which allow for "always on" data access, such as an Internet connection through a mobile handset, on its mobile network since it introduced such services at the end of 2000 in Lisbon and Oporto and October 2001 in all other areas of Portugal. TMN also is focusing on improving its indoor coverage in larger metropolitan areas. In 2002, TMN introduced MMS.

Roaming. Roaming agreements between operators allow their subscribers to make and receive voice calls automatically, send and receive data, or access other services when traveling outside the geographical coverage area of the home network, by using a visited network. As of the end of 2003, TMN had entered into roaming agreements with a total of 262 operators in 159 countries or regions. Since November 2000, it has been possible for Telesp Celular subscribers to use TMN's network in Portugal and TMN's roaming partners' networks. At the same time, TMN's subscribers can use Telesp Celular's network in Brazil and TCP's Brazilian roaming partners' networks, in each case with a handset and mobile telephone card that is compatible with the network. In April 2002, TMN entered into a GPRS roaming agreement with Telefónica.

Equipment Sales. TMN sells mobile phones and related equipment in Portugal. Equipment sales generated operating revenues of €133.5 million in 2003, €133.9 million in 2002 and €164.0 million in 2001.

Brazilian Mobile Business

Until recently, our mobile operations in Brazil, a country with a population of about 177 million people, had been active only in the states of São Paulo, Paraná and Santa Catarina. On January 23, 2001, we entered into a strategic agreement with Telefónica Móviles to aggregate all of our combined mobile assets in Brazil to the extent permitted under Brazilian law. The strategic agreement was approved by the European Commission on March 13, 2001. ANATEL advised us in May 2001 that the joint venture could be formed provided that neither we nor Telefónica Móviles could transfer to the mobile joint venture company more than 19.99% of the ordinary shares with voting rights of the mobile service companies controlled by each of us in Brazil. This limitation was applicable until such time as the mobile service companies to be contributed to the mobile joint venture company migrated from the former SMC mobile services licensing regime to the new SMP mobile services licensing regime. See "*Regulation Brazil*." On December 10, 2002, ANATEL formally approved the migration of our Brazilian mobile subsidiaries from the SMC regime to the SMP regime and the transfer of all of our direct and indirect interests in Brazilian mobile services companies to the mobile joint venture company.

On December 27, 2002, PT Móveis, which holds our interests in Brazilian mobile services companies, and Telefónica Móviles transferred their direct and indirect interests in Brazilian mobile services companies to the joint venture company, operating under the brand name Vivo. Portugal Telecom and Telefónica Móviles transferred to Vivo all their interests in:

TCP, which controls Telesp Celular (the band A operator in the state of São Paulo), Global Telecom (the band B operator in the states of Paraná and Santa Catarina) and Tele Centro Oeste Participações, S.A., or TCO (a band A operator in the Midwestern and Northern regions of Brazil), and was contributed by PT, which had a controlling position, and by Telefónica Móviles;

Tele Sudeste Celular Participações, S.A., which controls Telerj Celular, S.A. (the band A operator in the state of Rio de Janeiro) and Telest Celular, S.A. (the band A operator in the state of Espírito Santo), and was contributed by Telefónica Móviles;

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Tele Leste Celular Participações, S.A., which controls Telebahia Celular, S.A. (the band A operator in the state of Bahia) and Telerpipe Celular, S.A. (the band A operator in the state of Sergipe), and was contributed by Telefónica Móviles; and

Celular CRT Participações, S.A., which controls CRT Celular, S.A. (the band A operator in the state of Rio Grande de Sul), and was contributed by Telefónica Móviles (which had a controlling position) and by us.

Vivo is the leading mobile company in Brazil, based on a total of 20.7 million active mobile telephones at December 31, 2003. The joint venture operates in 20 states in Brazil, including the Federal district of Brasília, which provide more than 83% of Brazil's GDP. In its areas of operation, Vivo had an estimated market share of approximately 56.2% at the end of 2003. We believe that the joint venture will facilitate our ability to serve our Brazilian subscribers on a seamless basis throughout Brazil. We expect to benefit from synergies in various areas, including marketing, promotional activities, distribution networks, call center management, network management and operations, information technology, procurement and support functions, as well as the deployment of new mobile data services for business users. We believe that the joint venture will enable us to respond more effectively to increased competition from existing operators, such as Telecom Itália Mobiles, Telecom Americas, Oi and Brasil Telecom, and from other mobile operators in the markets we serve.

We have described the arrangements by which we and Telefónica Móviles own and manage the joint venture and related issues below in "*Strategic Alliances Alliance with Telefónica*". We have described certain regulatory restrictions applicable to Vivo and its subsidiaries which result from their relationship with Telefónica, including the inability of Vivo and its subsidiaries to provide wireline long distance services in Brazil, below in "*Regulation Brazil SMP Regulation*". See also "*Item 3 Key Information Risk Factors The Conditions Applying to Vivo's Subsidiaries Under the New SMP Licensing Regime may Result in Reducing Our Revenues and Results of Operations*".

Although we transferred all of our interests in mobile telecommunications companies in Brazil to Vivo on December 27, 2002, our consolidated statements of income and cash flows for the year ended December 31, 2002 continued to fully consolidate TCP's results. However, our balance sheet as of December 31, 2002 proportionally consolidates all the assets and liabilities of Vivo. Both our consolidated statements of income and cash flow for the year ended December 31, 2003 and our balance sheet as of December 31, 2003 proportionally consolidate the results of Vivo.

On December 27, 2002, TCP purchased the remaining 51% of the voting shares of Global Telecom. In our consolidated statements of income and cash flows for the year ended December 31, 2002, we continued to account for the results of operations of Global Telecom based on the equity method of accounting. However, TCP's balance sheet as of December 31, 2002, fully consolidates all the assets and liabilities of Global Telecom and accordingly our balance sheet proportionally consolidates all the assets and liabilities of Global Telecom. Both our consolidated statements of income and cash flows for the year ended December 31, 2003 and our balance sheet as of December 31, 2003 proportionally consolidate the results of Global Telecom. See "*TCP and Telesp Celular*", below.

On April 25, 2003, TCP acquired a controlling interest in TCO. As a result, TCO's assets and liabilities as of December 31, 2003 are reflected in our consolidated balance sheet as of December 31, 2003 through our proportional consolidation of Vivo, and TCO's income and cash flows from May through December 2003 are reflected in our consolidated statements of income and cash flows for the year ended December 31, 2003 through our proportional consolidation of Vivo's statements of income and cash flows. See "*TCP and Telesp Celular*" and "*Tele Centro Oeste Participações*" below.

The diagram below presents, in a simplified way, the ownership structure of Vivo:

*

These percentages correspond to the proportion of voting shares owned, directly or indirectly, by Vivo.

Regions. Vivo provides telecommunications services in Brazil through the following subsidiaries and in the regions described below:

Telesp Celular provides mobile telecommunications services on band A in the state of São Paulo, covering approximately 248,209 square kilometers, representing approximately 2.9% of Brazil's territory. This area includes more than 39.3 million people, representing 22.0% of Brazil's population, and 63 municipalities with populations in excess of 100,000, including the City of São Paulo, Brazil's largest city, with more than ten million people.

Global Telecom provides mobile telecommunications services on band B in the states of Paraná and Santa Catarina. This area is composed of 294,661 square kilometers, representing approximately 3.5% of Brazil's territory, with a population of approximately 15.6 million people, representing 8.8% of Brazil's population, and 22 municipalities with populations in excess of 100,000 people.

Tele Sudeste Celular provides mobile telecommunication services on band A in the states of Rio de Janeiro and Espírito Santo, covering 96% of the population of Vivo's authorization areas.

Tele Leste Celular provides mobile telecommunication services on band A in the states of Bahia and Sergipe, covering 68% of the population of Vivo's authorization areas.

CRT Celular provides mobile telecommunication services on band A in the state of Rio Grande do Sul, covering 96% of the population of Vivo's authorization areas.

TCO provides mobile telecommunications services in Brazil's Federal District and in 11 Brazilian states, including Acre, Goiás, Tocantins, Mato Grosso, Mato Grosso do Sul and Rondônia on band A and Pará, Amazonas, Amapá, Roraima, and Maranhão on band B. These areas are composed of 5.8 million kilometers and 31.8 million people, representing 68.0% of Brazil's territory and 18.0% of Brazil's population, and 34 municipalities with populations in excess of 100,000 people.

TCP and Telesp Celular

	<u>2001</u>	<u>2002</u>	<u>2003</u>
<i>Telesp Celular Operating information</i>			
Cellular lines in service at year-end (in thousands)	5,104	6,060	7,495
Customer growth during year	18.6%	18.7%	23.7%
Prepaid lines in service at year-end (in thousands)	3,735	4,634	6,019
Churn(1)	20%	17%	22%
Estimated population of authorization area at year-end (million)(2)	37.7	38.3	39.0
Estimated covered population at year-end (millions)(3)	36.7	37.2	38.4
Percentage of population covered(4)	97.3%	97.1%	98.4%
Penetration at year-end(5)	21.0%	23.8%	30.3%
<i>TCP Financial information(6)</i>			
Net operating revenues (in millions of Reais)	2,946.2	3,415.0	6,046.4
Net Income (loss)(in millions of Reais)	(1,113.6)	(1,140.8)	(640.2)
Total assets (in millions of Reais)	6,872.2	9,654.4	13,473.3

- (1) Churn is the number of customers that leave Telesp Celular during the year, calculated as a percentage of the simple average of customers at the beginning and the end of the year.
- (2) Projections based on estimates of the Instituto Brasileiro de Geografia e Estatística IBGE and Target 2002 "Brasil em Foco".
- (3) Number of people within the region that can access the cellular telecommunications signal.
- (4) Percentage of the population in the region that can access the cellular telecommunications signal.
- (5) Number of cellular lines in service in the region, including competitors, divided by the population of the region.
- (6) Data taken from TCP's consolidated financial statements prepared under Brazilian GAAP, which include (i) the results of Global Telecom for 2001 and 2002 recorded by the equity method of accounting and Global Telecom's income and cash flows for 2003 fully consolidated and (ii) TCO's income and cash flows from May through December 2003 fully consolidated.

Telesp Celular is part of our mobile joint venture with Telefónica and is 100% owned by TCP. Telesp Celular is the leading mobile telephone operator in the Brazilian state of São Paulo and in Brazil. São Paulo has a population of approximately 39 million people and is the most economically developed state in Brazil. The state of São Paulo contributes around 34.9% of Brazil's GDP. As of December 31, 2003, mobile penetration in the state of São Paulo was 30%, compared to an average of 28% in the rest of Brazil. Telesp Celular's operating revenues were R\$3,993.2 million in 2003, R\$3,415.0 in 2002 and R\$2,946.2 million in 2001.

On March 11, 2002, TCP announced its intention to undertake an overall capital increase of its common and preferred shares, including preferred shares underlying its ADSs. As part of this overall capital increase, TCP offered holders of its preferred shares rights to subscribe for new preferred shares, holders of its ADSs rights to subscribe for new ADSs and holders of its common shares rights to subscribe for new common shares. TCP successfully completed its rights offering in September 2002, which generated proceeds of R\$2,403 million.

Portugal Telecom subscribed to a total of 247,224 million common shares and 326,831 million preferred shares in this rights offering. As a result, as of September 2002, we owned 93.7% of TCP's common shares and 49.8% of TCP's preferred shares, representing an economic interest of 65.12%. In October 2002, in connection with the formation of the joint venture, we sold a 14.68% stake in TCP to

Telefónica Móviles, reducing our economic interest in TCP to 50.44%. On December 27, 2002, we transferred the rest of our interest in TCP to Vivo. We now hold our interest in TCP, as well as our interest in the other mobile services companies that were transferred to Vivo, indirectly, on a 50/50 basis with Telefónica Móviles.

In February and July 2001, TCP acquired an 81.61% indirect economic interest in Global Telecom, through the acquisition of 49% of the voting shares and 100% of the non-voting shares of each of three holding companies that controlled Global Telecom. The total purchase price was R\$902.6 million. On December 11, 2002, after all of the TCP operators had switched over to the new SMP regulatory licensing regime, ANATEL approved TCP's acquisition of the remainder of the shares and, on December 27, 2002, TCP acquired the remaining 51% of the voting shares of the three holding companies that owned Global Telecom for US\$82.0 million. TCP now owns 100% of the voting and non-voting shares of Global Telecom.

On April 25, 2003, TCP acquired 61.1% of TCO's voting capital stock from the Brazilian company, Fixcel. The purchase price was R\$1,529 million, which corresponded to R\$19.5 per each lot of 1,000 common shares acquired. On November 18, 2003, TCP acquired an additional 25.5% of the common shares of TCO in a tender offer to TCO minority shareholders for R\$538.8 million. Following the tender offer, TCP now holds 86.6% of the voting capital stock and 28.9% of the total capital stock of TCO, including treasury shares held by TCO. On October 31, 2003, TCP attempted to acquire the remaining share capital of TCO by means of a merger of TCO shares into TCP shares. The exchange ratio was fixed at 1.27 TCP shares for each TCO share held. This merger was cancelled on January 12, 2004 following the issuance of an opinion by the Brazilian Securities and Exchange Commission that the merger did not fully comply with current Brazilian law.

Global Telecom

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Cellular lines in service at year-end (in thousands)	862	1,177	1,691
Customer growth during year	86%	36.5%	43.7%
Prepaid lines in service at year-end (in thousands)	539	924	1,409
Churn(1)	23%	20%	18%
Estimated population of authorization area at year-end (millions)(2)	15.1	15.3	15.6
Estimated covered population at year-end (millions)(3)	10.6	11.0	11.9
Percentage of population covered(4)	71%	74%	76%
Penetration at year-end(5)	17%	19%	24%
Net operating revenues (in millions of Reais)(6)	425.9	512.2	669.0
Net Income (in millions of Reais)(6)	(856.1)	(771.1)	(436.0)
Total assets (in millions of Reais)(6)	2,632.8	2,383.6	2,128.5

- (1) Churn is the number of customers that leave Global Telecom during the year, calculated as a percentage of the simple average of customers at the beginning and the end of the year.
- (2) Projections based on estimates of the Instituto Brasileiro de Geografia e Estatística IBGE and Target 2002 "Brasil em Foco".
- (3) Number of people within the region that can access the cellular telecommunications signal.
- (4) Percentage of the population in the region that can access the cellular telecommunications signal.
- (5) Number of cellular lines in service in the region, including competitors, divided by the population of the region.
- (6) Data taken from financial statements prepared under Brazilian GAAP.

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Under the terms of Global Telecom's authorization from ANATEL, it operates in the states of Paraná and Santa Catarina. These two states have a combined population of approximately 15.6 million and together generate approximately 10% of Brazil's gross domestic product. As of December 31, 2003, mobile phone penetration in Global Telecom's authorization areas was 24%, as compared with an average of 28% in the rest of Brazil. As of December 31, 2003, Global Telecom's service area reached more than 76% of the urban population of those areas and Global Telecom had 1,691,012 subscribers, representing an estimated market share of 45%, as compared to 41% at year end 2002. Global Telecom introduced pre-paid products in 2000 and made significant investments in 2001, 2002 and 2003 to expand the coverage of its network service, as well as to offer mobile data services with potential speeds of up to 14.4 kb per second.

Tele Sudeste Celular Participações

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Cellular lines in service at year-end (in thousands)	3,028	3,455	3,709
Customer growth during year	21.0%	14.1%	7.4%
Prepaid lines in service at year-end (in thousands)	2,023.3	2,368.2	2,552
Churn(1)	17.9%	18.2%	29.5%
Estimated population of authorization area at year-end (millions)(2)	17.9	18.0	18.1
Estimated covered population at year-end (millions)(3)	15.3	15.8	17.4
Percentage of population covered(4)	85.9%	87.4%	96.0%
Penetration at year-end(5)	27.7%	32.7%	41.0%
Net operating revenues (in millions of Reais)(6)	1,703.3	1,847.6	1,892.5
Net Income (in millions of Reais)(6)	162.9	140.4	156.2
Total assets (in millions of Reais)(6)	2,690.6	2,793.8	2,823.4

- (1) Churn is the number of customers that leave Telerj Celular and Telest Celular, taken together, during the year, calculated as a percentage of the simple average of customers at the beginning and the end of the year.
- (2) Projections based on estimates of the Instituto Brasileiro de Geografia e Estatística IBGE and Target 2002 "Brasil em Foco".
- (3) Number of people within the region that can access the cellular telecommunications signal.
- (4) Percentage of the population in the region that can access the cellular telecommunications signal.
- (5) Number of cellular lines in service in the region, including competitors, divided by the population of the region.
- (6) Data taken from financial statements prepared under Brazilian GAAP.

Tele Sudeste Celular Participações, or Tele Sudeste, holds 100% of Telerj Celular, the leading mobile telephone operator in the state of Rio de Janeiro, and 100% of Telest Celular, the leading mobile operator in the state of Espírito Santo. These states have a combined population of approximately 18 million people and together contribute around 13.5% of Brazil's GDP. As of December 31, 2003, mobile penetration in Tele Sudeste's authorization areas was 41%, compared to an average of 28% in the rest of Brazil. At December 31, 2003, Telerj Celular and Telest Celular had approximately 3.7 million cellular lines in service, of which approximately 2.6 million were prepaid. Tele Sudeste's consolidated operating revenues were R\$1,893 million in 2003, R\$1,848 million in 2002 and R\$1,703 million in 2001.

Tele Leste Celular Participações

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Cellular lines in service at year-end	822	973	1,126
Customer growth during year	22.0%	18.3%	15.8%
Prepaid lines in service at year-end	499	673	835
Churn(1)	19.8%	25.5%	33.0%
Estimated population of authorization area at year-end (million)(2)	15.1	15.1	15.4
Estimated covered population at year-end (million)(3)	9.3	9.5	10.5
Percentage of population covered(4)	62%	63%	68%
Penetration at year-end(5)	8.9%	10.6%	13.4%
Net operating revenues (in millions of Reais)(6)	386.3	431.4	441.3
Net Income (loss) (in millions of Reais)(6)	(6.0)	(5.1)	(42.7)
Total assets (in millions of Reais)(6)	861.5	956.7	831.7

- (1) Churn is the number of customers that leave Telebahia Celular and Telergipe Celular during the year calculated as a percentage of the simple average of customers at the beginning and the end of the year.
- (2) Projections based on estimates of the Instituto Brasileiro de Geografia e Estatística IBGE and Target 2002 "Brasil em Foco".
- (3) Number of people within the region that can access the cellular telecommunications signal.
- (4) Percentage of the population in the region that can access the cellular telecommunications signal.
- (5) Number of cellular lines in service in the region, including competitors, divided by the population of the region.
- (6) Data taken from the financial statements prepared under Brazilian GAAP.

Tele Leste Celular Participações, or Tele Leste, holds 100% of Telebahia Celular, the leading mobile telephone operator in the state of Bahia and 100% of Telergipe Celular, the leading mobile operator in the state of Sergipe. These states have a combined population of approximately 15.4 million people and together contribute around 5% of Brazil's GDP. As of December 31, 2003, mobile penetration in Tele Leste's authorization areas was 13%, compared to 28% in the rest of Brazil. At December 31, 2003, Tele Leste had approximately 1.1 million cellular lines in service, of which approximately 0.8 million were prepaid. Tele Leste's operating revenues were R\$441 million in 2003, R\$431 million in 2002 and R\$386 million in 2001.

CRT Celular

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Cellular lines in service at year-end (in thousands)	1,785	2,078	2,523
Customer growth during year	22.9%	16.4%	21.4%
Prepaid lines in service at year-end (in thousands)	1,206	1,466	1,836
Churn(1)	17%	16%	21%
Estimated population of authorization area at year-end (millions)(2)	10.0	10.5	10.6
Estimated covered population at year-end (millions)(3)	8.2	8.6	10.2
Percentage of population covered(4)	82%	82%	96%
Penetration at year-end(5)	26%	30%	39%
Net operating revenue (in millions of Reais)(6)	840.4	896.3	1,032.7
Net Income (in millions of Reais)(6)	102.9	147.6	189.4
Total assets (in millions of Reais)(6)	1,417.3	1,678.7	1,739.5

- (1) Churn is the number of customers that leave CRT Celular during the year, calculated as a percentage of the simple average of customers at the beginning and the end of the year.
- (2) Projections based on estimates of the Instituto Brasileiro de Geografia e Estatística IBGE and Target 2002 "Brasil em Foco".
- (3) Number of people within the region that can access the cellular telecommunication signal.
- (4) Percentage of the population in the region that can access the cellular telecommunication signal.
- (5) Number of cellular lines in service in the region, including competitors, divided by the population of the region.
- (6) Data taken from financial statements prepared under Brazilian GAAP.

CRT Celular is the leading mobile telephone operator in the state of Rio Grande do Sul. The state of Rio Grande do Sul has a population of approximately 10.6 million people and contributes around 8% of Brazil's GDP. As of December 31, 2003, mobile penetration in CRT Celular's authorization area was 39%, compared to 28% in the rest of Brazil. At December 31, 2003, CRT Celular had approximately 2.5 million cellular lines in service, of which approximately 1.8 million were prepaid. CRT Celular's operating revenues were R\$1,033 million in 2003, R\$896 million in 2002 and R\$840 million in 2001.

Tele Centro Oeste Participações

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Cellular lines in service at year-end (in thousands)	2,412	3,067	4,112
Customer growth during year	42.2%	27.2%	34.1%
Prepaid lines in service at year-end (in thousands)	1,717	2,207	3,162
Churn(1)	23.4%	20.5%	23.8%
Estimated population of authorization area at year-end (millions)(2)	30.7	31.2	31.8
Estimated covered population at year-end (millions)(3)	21.6	23.0	24.2
Percentage of population covered(4)	70%	74%	76%
Penetration at year-end(5)	12.8%	16.3%	23.3%
Net operating revenues (in millions of Reais)(6)	1,248.1	1,572.1	1,958.9
Net Income (in millions of Reais)(6)	208.1	329.2	463.4
Total assets (in millions of Reais)(6)	2,052.1	2,364.7	2,654.2

- (1) Churn is the number of customers that leave the mobile operating subsidiaries of TCO during the year, calculated as a percentage of the simple average of customers at the beginning and the end of the year.
- (2) Projections based on estimates of the Instituto Brasileiro de Geografia e Estatística IBGE and Target 2002 "Brasil em Foco".
- (3) Number of people within the region that can access the cellular telecommunications signal.
- (4) Percentage of the population in the region that can access the cellular telecommunications signal.
- (5) Number of cellular lines in service in the region, including competitors, divided by the population of the region.
- (6) Data taken from financial statements prepared under Brazilian GAAP.

Certain mobile operating subsidiaries of TCO use a frequency range known as band A that covers 49% of the municipalities in the Brazilian states of Acre, Distrito Federal, Goiás, Mato Grosso, Mato Grosso do Sul, Rondônia and Tocantins and 89% of the population of those states. Another mobile operating subsidiary uses a frequency range known as band B that covers 27% of the municipalities in the Brazilian states of Amazonas, Amapá, Maranhão, Pará and Roraima and 65% of the population of those states. At December 31, 2003, the mobile operating subsidiaries of TCO had 4.1 million cellular lines in service, which represented a 34.1% net increase from December 31, 2002, and a market share of approximately 55.6% in the states in which it operates.

Services. Vivo provides mobile telecommunications services using both digital and analog technologies. Vivo's network provides both CDMA digital service and AMPS, or analog services, through TCP, Tele Sudeste and Tele Leste. TCO and CRT Celular provide mobile telecommunications services using CDMA/TDMA digital technology and AMPS analog technology. All Vivo's services are provided in the 850 MHz frequency range.

Vivo offers voice service, ancillary services, including voicemail and voicemail notification, call forwarding, three-way calling, caller identification, short messaging, limitation on the number of used minutes, mobile chat room, and data services, such as WAP, through which clients can access WAP sites and portals. At December 31, 2003, 56% of Vivo's total subscribers already had WAP-enabled handsets. Vivo offers high speed data services that (i) provide direct access to the Internet through either PCMCIA cards designed to connect compatible PDA's and laptops to 2.5G service or through 2.5G mobile phones by cable connection and (ii) offer corporate subscribers secure access to their intranet and office resources.

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In 2003, Vivo launched MMS and MExE (Mobile Execution Environment) that enable customers to download and execute applications through their mobile handsets. Also, Vivo launched a user-friendly interface, with icons on individual mobile handsets that identify the main services provided, such as Voice Mail, Downloads and SMS.

Vivo offers roaming services through agreements with local mobile service providers throughout Brazil and other countries that allow its subscribers to make and receive calls while out of its concession areas. Also Vivo provides reciprocal roaming services to subscribers of those mobile service providers while they are in its concession areas. See " *Roaming*".

Subscribers and Traffic. At the end of 2003, there were approximately 45.7 million wireless subscribers in Brazil, and there was an estimated market penetration rate of approximately 28% in the areas where Vivo operates. In 2003, the Brazilian market experienced a 30% increase in the number of wireless subscribers and a 33% increase in those areas where Vivo operates. The greatest increase in subscribers was in the Brazilian states of São Paulo, Rio de Janeiro, Rio Grande do Sul and the Cento Oeste region. As of December 31, 2003, Vivo had approximately 20.7 million wireless subscribers, with an estimated market share of 56% in its areas of operation and 45% in Brazil.

The subscriber growth in Vivo's operating companies was supported by (i) the launch of new products and services, including prepaid products and new messaging services, (ii) the growth of the digital capacity of the network, (iii) the improvement in CRM systems, (iv) marketing campaigns and promotions, and (v) the restructuring and expansion of sales networks.

Marketing. Vivo closely follows developments in the markets where it operates and often launches new segment-specific promotions through direct marketing, including mailing and telemarketing campaigns, as well as promotions to its competitors' major customers. Efforts to acquire new customers for the pre-paid and post-paid services were mostly made through voice and data services promotions designed to increase on-net traffic and stimulate the use of data services. With the simultaneous goal of maintaining its existing customer base, Vivo's promotions were also open to existing customers who wanted to change their mobile handsets. Vivo's operators were actively involved in a high-value customer loyalty program, offering competitive discounts on mobile phones through direct marketing actions.

Customer Service. As part of its strategy to standardize customer service provided by Vivo's operators, Vivo has outsourced 100% of its customer service while maintaining full management control. Customer service is available on a 24-hour basis from Vivo's call centers and through its website.

Customer satisfaction is evaluated regularly. In 2003 more than 8,700 Vivo customers were interviewed across Brazil in 2003 to gather their opinions about customer assistance, technical assistance, products and services. Vivo's average overall satisfaction mark was 8.25 on a scale of 1 to 10. Vivo continues to search for ways to increase further customer satisfaction.

Vivo has trained or qualified staff to assist and provide explanations to customers in connection with any requests or doubts they may have concerning services provided. Vivo attempts to respond to all customer requests.

Vivo was ranked first in 2003 in a nationwide poll conducted by the IBRC (Brazilian Institute of Customer Relations) on "companies that most respect consumers", the results of which were published in the Consumidor Moderno (Modern Consumer) magazine.

Network and Capital Expenditures. Vivo's networks are connected primarily through fiber-optic transmission systems leased from incumbent wireline operators in the areas in which it operates, consisting of mobile switches, base stations and other network elements, such as voicemail, prepaid service, Short Message Service, Home Location Registers, Signaling Transfer Point, PDSN and

gateways. Vivo's main suppliers are NEC do Brasil S.A., Nortel Networks, Motorola do Brasil Ltda., Lucent Technologies do Brasil, Ind. e Com. Ltda. and Ericsson Telecomunicações S.A.

Vivo's operating companies' networks use analog and digital technology. Digitalization offers certain advantages, such as greater network capacity and additional revenue through the sale of value-added services. Digital mobile telecommunications service also reduces the risk of fraud. Vivo continues to increase network capacity and coverage to improve the quality of service and to meet customer demand.

Before November 1998, TCP's network used only AMPS analog technology. After its privatization in 1998, TCP began to use CDMA digital technology. At December 31, 2003, Telesp Celular's telecommunications network, which provides both CDMA digital and AMPS analog services, covered 77% of the municipalities in the state of São Paulo, or 98% of the population, in its authorization area.

Global Telecom only offers services through CDMA digital technology. At December 31, 2003, Global Telecom's telecommunications network covered 29% of the municipalities, or 76% of the population, in its authorization areas.

At December 31, 2003, Tele Sudeste's telecommunications network, which provides CDMA digital and AMPS analog services, covered 100% of the municipalities, or 96% of the population, in its authorization areas.

At December 31, 2003, Tele Leste's telecommunications network, which provides CDMA digital and AMPS analog services, covered 31% of the municipalities, or 68% of the population, in its authorization areas.

At December 31, 2003, CRT Celular's telecommunications network, which provides CDMA digital, TDMA digital and AMPS analog services, covered 68% of the municipalities, or 96% of the population, in its authorization areas.

At December 31, 2003, TCO's telecommunications network, which provides CDMA digital, TDMA digital and AMPS analog services, covered 40% of the municipalities, or 76% of the population, in its authorization areas.

Vivo's advanced network management technology ensures global management and supervision of all its network processes and network performance. The network management centers are located in São Paulo, Brasília, Rio de Janeiro, Salvador and Porto Alegre. The São Paulo network management center monitors the critical network operational parameters of Telesp Celular and Global Telecom. The Brasília network management center monitors such parameters for TCO, as does the Rio de Janeiro center for Tele Sudeste, the Salvador center for Tele Leste and the Porto Alegre center for CRT Celular. These centers are able to identify abnormalities in Vivo's networks and in third-party networks, using the failure and signal monitoring systems. In addition, quality and service standards are constantly monitored. The network management centers are integrated with the maintenance and operations teams that maintain and operate the mobile networks, and with the mobile infrastructure and transmission teams, radio network elements, computing bases, service platforms and communications backbone. Vivo's network is prepared to provide continuity of service for its customers in the event of network interruptions. Vivo has developed contingency plans relating to catastrophes in its switching centers, power supply interruptions and security breaches.

Vivo's expenditures over the past three years related primarily to increasing network capacity and coverage. During the year ended December 31, 2003, R\$1,176 million was invested in fixed assets, mainly in projects for the improvement and expansion of Vivo's service capacity, the selective implementation of the 1xRTT network, which was overlaid on TCO's and CRT Celular's TDMA networks, upgrading Tele Sudeste's, Tele Leste's and Global Telecom's networks to 1xRTT, offering new services, developing a backbone and systems integration at Vivo, and on various consulting projects.

The expenditures in 2003 represent 11.4% of Vivo's operating revenues. Capital expenditures for 2002 and 2001 were R\$888 million and R\$1,622, respectively.

Interconnection Charges. With the introduction of personal mobile services through the new SMP licensing regime in Brazil, Vivo's operators began working as local operators. This means that each operator is responsible for the traffic originated in its authorization area. Calls placed between authorization areas must use a long distance carrier. As a result, for every call in Vivo's authorization areas, Vivo receives a fee for the use of its network in respect of calls originated on its network. For long distance calls terminated on Vivo's network, Vivo receives a fee from the respective long distance carrier for the use of Vivo's network, regardless of the network that originated the call. For long distance calls between authorization areas originated on Vivo's network, Vivo also receives a fee from the long distance carrier for the use of its network for call origination. Vivo earns revenues from any call that originates from another mobile or fixed-line service provider's network, which connects to one of Vivo's customers. Vivo charges the service provider from whose network the call originates a network usage charge for every minute that Vivo's network is used in connection with the call. See " *Regulation Brazil*".

In February 2003 and again in February 2004, ANATEL authorized all Vivo's operating companies to increase their tariffs per minute. Mobile operating companies are now obligated to grant a 30% discount during off peak hours on certain tariffs for local calls originating with Telesp Fixa, in the case of Telesp Celular, Brasil Telecom and Sercomtel, in the case of Global Telecom, Brasil Telecom, in case of TCO and CRT Celular, and Telemar, in case of Tele Sudeste and Tele Leste.

Roaming. Vivo has agreements pertaining to automatic roaming with all mobile CDMA/TDMA service providers in Brazil and with some wireless service operators abroad. These contracts allow its subscribers to access the network of other mobile service providers when traveling outside its coverage area without having to change their handsets or mobile numbers. Vivo provides reciprocal services to subscribers of other mobile service providers when they are within its coverage area. The agreements require the contracting parties to provide service to roaming subscribers on the same basis as they provide service to their own subscribers. Roaming charges are reconciled monthly.

Vivo offers automatic international roaming in the United States, Mexico, Canada, the Caribbean, Argentina, Uruguay and South Korea. Since 1999 it has provided international GSM services through the use of GSM handsets in most parts of Europe, Africa, Asia and Oceania.

License. Under the new SMP regime, Vivo converted its former concessions to new SMP licenses. These SMP licenses have substantially the same terms and conditions as the other new SMP licenses issued under the new regime, although certain terms of Vivo's former concessions, such as limits on prices charged to subscribers under its postpaid service plan (the Basic Plan), continue to apply despite conversion to SMP licenses. Conversion to SMP licenses offers Vivo greater flexibility in setting its prices, particularly its interconnection fees, even though Vivo is now limited by the price caps established in its former concession agreements until June 30, 2004.

By converting its concessions to SMP licenses, Vivo was required to introduce carrier selection on its network to give its subscribers the choice to use another carrier for long distance and international calls. The introduction of carrier selection increased the competitive pressures on Vivo's business. In addition, because the SMP regime permits commercial negotiation of the interconnection rates it charges to wireline operators, Vivo may be forced to reduce such rates in the future. Vivo's SMP licenses expire on the same dates as the concessions were to have expired. Vivo has the same right to apply for renewal as other SMP license holders that migrate to the SMP regime from their existing concessions.

Bill and Keep. Under the SMP system, usage of the network remuneration between SMP mobile operators will only be due if traffic carried in the same registration area between two networks, in a

given direction, exceeds 55% of the total traffic exchanged between them. In this case, only those calls which have surpassed the 55% threshold will be subject to payment for network usage. This rule is valid until June 30, 2005. Thereafter, SMP operators will adopt full Bill and Keep, by which no remuneration will be due for network usage among SMP networks, regardless of the amount of carried traffic.

Equipment Sales. Although Vivo still has some subscribers using analog service (approximately 0.9% of TCP subscriber base, 0.8% of TCO, 2.3% of Tele Sudeste, 2.4% of CRT Celular and 8.1% of Tele Leste at December 31, 2003), it has implemented a series of actions, such as providing discounts on digital handsets, discounts on monthly fees for digital services, digital handset rentals and free digital handsets to its high-value subscribers, to encourage remaining analog subscribers to migrate to digital service. Vivo's revenues from sales of handsets and accessories were R\$1.9 million in 2003 and R\$1.3 million in 2002.

Management. TCP's Board of Directors has eleven members, five elected by Portugal Telecom, five by Telefónica and one elected by minority shareholders, in accordance with Brazilian corporate law. Tele Leste, Tele Sudeste, CRT Celular and TCO each have ten members on their Boards of Directors, five elected by Portugal Telecom and five by Telefónica. Portugal Telecom elects the Chief Executive Officer and Telefónica elects the Chief Financial Officer for each of Vivo's operating companies.

Multimedia Businesses

We provide multimedia services in Portugal through our subsidiary PT Multimedia and its subsidiaries. Operating revenues from our multimedia businesses were €683.5 million in 2003, €621.9 million in 2002 and €571.2 million in 2001.

Formation and Development. Portugal Telecom formed PT Multimedia in July 1999 and transferred to the new company certain of our cable and satellite pay-TV activities as well as our Internet-related activities focused on residential customers and the small office home office and small and medium-sized enterprise markets, including:

our cable television pay-TV operations through cable and DTH satellite;

cable and direct-to-home satellite programming activities;

advertising sales;

the provision of Internet access; and

our minority stake in the leading Portuguese telephone directories business.

After an initial public offering of ordinary shares of PT Multimedia in November 1999, PT Multimedia's shares are now traded publicly. During the course of 2002 and 2003, we acquired 2.43% and 1.08%, respectively, of PT Multimedia in the open market. As of December 31, 2003, Portugal Telecom held 57.56% of PT Multimedia.

In March 2000, PT Multimedia created PT Conteúdos to hold its interests in programming ventures, and PT Multimedia.com, or PTM.com, to which it transferred its Internet-related assets. See "*PTM.com*", above.

In April 2000, PT Multimedia acquired 42.0% of Lusomundo, a leading media and entertainment company in Portugal, through a tender offer on the Euronext Lisbon Stock Exchange. On March 26, 2001, PT Multimedia acquired 57.9% of Lusomundo, after approval from the Portuguese competition authorities in January 2001, thereby increasing its ownership interest in Lusomundo to 99.9% of Lusomundo's share capital. Approval was given on condition that PT Multimedia ensures that content produced by and supplied to Lusomundo, in which it does not face significant present or future

competition, will be made available to third parties in accordance with normal market practice and the policy of transparency and non-discrimination that applies to other members of the Portugal Telecom group.

As a result of the acquisition, PT Multimedia incurred a liability of €268.5 million payable to CINVESTES-SGPS, S.A. On June 20, 2001, in exchange for the contribution of such liability to Portugal Telecom, CINVESTES acquired 28.5 million of Portugal Telecom's ordinary shares at a price of €9.40 per share in connection with a share capital increase approved by Portugal Telecom's shareholders on February 5, 2001. PT Multimedia repaid the liability that it owed to Portugal Telecom with the proceeds from a rights issue completed in July 2001.

In June 2000, PTM.com increased its share capital, issued new shares in a public offering to PT Multimedia's shareholders and was listed on the Euronext Lisbon Stock Exchange. On June 20, 2000, PT Multimedia sold approximately 7.5% of the share capital of PTM.com in a private placement to two strategic shareholders, Banco Espírito Santo and Caixa Geral de Depósitos, and to PPTV, a shareholder in its joint venture, Sport TV.

In January 2001, PT Multimedia announced the launch of an exchange offer in Portugal to acquire all of the outstanding shares of PTM.com that it did not already hold in exchange for PT Multimedia shares. The exchange offer was approved by PT Multimedia's shareholders on September 19, 2001. PTM.com shareholders received one PT Multimedia share for every 3.4908 PTM.com shares tendered. After completion of the exchange offer on December 3, 2001 PT Multimedia held 98.76% of the share capital of PTM.com. Pursuant to a compulsory acquisition permitted by Portuguese law, PT Multimedia acquired the remaining 4,186,593 ordinary shares of PTM.com that it did not already own and delisted PTM.com's shares from the Euronext Lisbon Stock Exchange in March 2002.

On October 17, 2002, we entered into an agreement with PT Multimedia to acquire its 100% interest in PTM.com, its 24.75% interest in Páginas Amarelas and its 50% interest in Sportinveste Multimedia. These acquisitions took effect as of September 30, 2002 and were completed at an aggregate acquisition price of €199 million. In addition, we also acquired €401 million in shareholder loans that PT Multimedia had extended to PTM.com and Sportinveste Multimedia. This transaction reduced the net debt of PT Multimedia by €600 million to €139 million. As from October 1, 2002, PT Multimedia no longer fully consolidates the financial results of PTM.com, which are now included in our wireline business.

Overview. PT Multimedia's businesses now consist of:

cable and satellite television through TV Cabo;

broadband Internet access through cable modem provided by TV Cabo;

TV programming activities through PT Conteúdos and its subsidiaries and affiliates;

cinema distribution, negotiation of cinema rights for all film exhibition windows and distribution of DVDs, videos, and videogames through Lusomundo Audiovisuais;

cinema exhibition through Lusomundo Cinemas; and

production and distribution of daily newspapers, news radio and a diverse range of magazines through Lusomundo Media.

The diagram below shows PT Multimedia's major businesses and the subsidiaries operating in each of those businesses.

TV Cabo. PT Multimedia provides cable television and direct-to-home satellite television services through TV Cabo, its wholly owned subsidiary, and TV Cabo's subsidiaries in Madeira and Azores. TV Cabo is also involved in advertising sales. In addition, it provides multimedia services, such as broadband cable Internet access and certain interactive digital television services.

Cable Television and Direct-to-Home Satellite Television Services. TV Cabo is the leading cable television operator in Portugal. Its cable television licenses cover approximately 77% of Portugal's population, comprising approximately 3.7 million homes. At December 31, 2003, TV Cabo's cable network passed, or provided potential access to, approximately 2.5 million homes. At December 31, 2003, TV Cabo had approximately 1.1 million cable customers, an increase of 10.2% over the end of 2002. TV Cabo's cable television subscribers are charged an installation fee, a monthly subscription fee for programming packages and, for those with access to premium channels, an annual rental fee for set-top boxes.

Since September 1998, TV Cabo has also distributed a direct-to-home, or DTH, satellite television service in Portugal. TV Cabo distributes its DTH satellite service using Hispasat Satellite broadcasting capabilities. TV Cabo's DTH satellite service is the only DTH digital multi-channel service specifically marketed in Portugal. TV Cabo's DTH satellite subscribers are charged an installation fee and a monthly subscription fee and are required either to purchase or rent from TV Cabo a satellite dish and a digital set-top box. TV Cabo's DTH satellite service is mainly targeted at people whose homes are not passed by TV Cabo's cable television network.

Because it offers cable and DTH satellite services, TV Cabo can distribute programming and advertising across Portugal. As of December 31, 2003, TV Cabo had approximately 1,442 thousand customers, of which 348 thousand were DTH satellite subscribers. At December 31, 2003, approximately 43% of TV Cabo's subscribers subscribed to its premium channels, for which it charges additional fees.

Programming Content. As of December 31, 2003, TV Cabo offered over 44 basic channels to cable and DTH satellite subscribers in continental Portugal. Seven premium channels are presently available to cable and DTH subscribers. About half of the channels distributed by TV Cabo, including Lusomundo Premium and Lusomundo Gallery and Sport TV, consist principally of programming that is in Portuguese or that has been dubbed or subtitled in Portuguese. The rest of the channels are mainly in English, but also in other European languages such as Spanish, French and German.

In March 2000, PT Multimedia (on behalf of PT Conteúdos) and TV Cabo established a strategic partnership with SIC, a major television operator in Portugal, to develop television content. This arrangement included the acquisition by SIC on September 4, 2000 of 60% of Lisboa TV, S.A., or Lisboa TV, the owner of a live news and information channel in Portugal, now known as "SIC Notícias", the production of two channels for TV Cabo's basic package and cross-promotion between SIC and TV Cabo. PT Conteúdos holds the other 40% of Lisboa TV.

In the first quarter of 2004, PT Multimedia initiated efforts to improve its basic and premium packages. In April 2004, PT Multimedia re-launched the Discovery Channel, with a programming grid specifically aimed at the Portuguese public, including content produced in Portugal, as part of its basic package. In addition, Lusomundo Action, PT Multimedia's newest premium cinema channel exclusively dedicated to the action genre, was launched in April 2004. This new channel fits into PT Multimedia's strategy of increasing Pay-TV service segmentation, thereby meeting the diverse needs of its client base. During 2004, PT Multimedia expects to make additional improvements to its basic package with the launch of international channels of recognized quality, as well as by increasing the amount of Portuguese content in its programming grid.

Multimedia Service. In order to increase its revenues per subscriber, TV Cabo has been developing a set of multimedia services, comprising broadband Internet access and the provision of digital services. TV Cabo launched broadband Internet access through cable modems at the end of 1999. This was the first broadband internet access service launched in Portugal. TV Cabo had approximately 230 thousand subscribers for its broadband Internet access product at the end of 2003. In May 2002, a new digital service was launched, allowing Pay TV customers to access digital services such as Electronic Programming Guide, multi-camera functionalities and video-on-demand. At the same time, the conditional access system was upgraded to NAGRA's ALADIN system. This was done to increase security levels and the degree of control over access to services.

Digitalization. Throughout 2003, PT Multimedia continued its efforts to digitalize its Pay TV services. At December 31 2003, PT Multimedia had over 172 thousand set-top boxes enabled for digital services. In September 2003, PT Multimedia launched a "request for proposals" in connection with the supply of new set-top boxes and this is now in its final phase. At the same time, negotiations are being carried out with foreign content suppliers, in order to strengthen digital services. PT Multimedia aims to stimulate the migration of its clients from analog to digital services by offering a greater selection of content and services.

Network. Between 1994 and year-end 2003, TV Cabo invested approximately €521 million, mainly in the development of a hybrid fiber-coaxial broadband distribution network. The network has a bandwidth of 750 MHz and is sufficient to permit gradual migration to digital signals. The current design of the network allows it to increase capacity without significant additional capital expenditure. TV Cabo has activated the two-way capacity of its bandwidth cable network which at the end of 2003 stands at 89% of houses passed by its network. This activation allowed it to introduce Internet access by cable at the end of 1999 and allowed it to launch its IDTV service in June 2001.

TV Cabo's television signals are transmitted through fiber optic cables owned by our fixed line business, PT Comunicações, under a service agreement. In addition, TV Cabo has used PT Comunicações existing ducts, wherever possible, to build its network. Because TV Cabo was able to

utilize those ducts, its cumulative 2003 capital expenditure per home passed, excluding last connection to the client, or cable drop, was approximately €92. As of December 31, 2003, TV Cabo's network reached approximately 2.2 million homes that have two-way capacity.

Marketing. TV Cabo is pursuing aggressive marketing campaigns. It is promoting its premium channels, and highlighting the high level of Portuguese-language content on its channels, the new digital services provided by its new digital set-top boxes and its broadband Internet access (NetCabo). TV Cabo markets its services through door-to-door selling, telemarketing and through Portugal Telecom shops, its own shops, supermarkets and other retail shops. We believe the alliance with SIC, Sport TV and other content producers has been contributing to the increased penetration of TV Cabo, as the agreement contemplates cross promotions between free and cable TV, and increased advertising initiatives.

PT Conteúdos. PT Multimedia created PT Conteúdos to manage the Portuguese-language audiovisual programming activities previously managed by TV Cabo. After restrictions on cable operators engaging in any programming business were lifted in 1997, TV Cabo formed two joint ventures to develop programming channels in Portugal (Sport TV and Premium TV) and launched CNL, now known as SIC Notícias (Lisboa TV), a live news, information and entertainment channel in Portuguese. These ventures were aggregated under PT Conteúdos, which is 100% owned by PT Multimedia.

Until June 2003, PT Conteúdos owned 54% of Premium TV, a partnership with Globo and SIC. In June 2003, PT Conteúdos acquired the remaining 46% of the share capital of Premium TV held by Globo and SIC. Globo is Brazil's leading television network, and a leading producer of Portuguese programming. SIC is a major television operator in Portugal. In June 1998, Premium TV launched two premium movie channels Telecine Premium and Telecine Gallery using the film libraries of Globo. Until May 2003, these channels were distributed via cable and satellite, through TV Cabo's platforms. Premium TV has also launched adult entertainment programming. In June 2003, PT Conteúdos decided to replace Telecine Premium and Telecine Gallery by launching two premium movie channels (Lusomundo Premium and Lusomundo Galery) produced in-house using the film libraries of Lusomundo. In April 2004, Lusomundo Action, the newest premium cinema channel exclusively dedicated to the action genre, was launched.

PT Conteúdos also owns 50% of Sport TV Portugal, S.A., or Sport TV, a joint venture with PPTV-Publicidade de Portugal e Televisão, S.A. PPTV is a subsidiary of Olivedesportos, a Portuguese sports marketing firm. This joint venture produces Sport TV, a premium sports channel, which is distributed by Portuguese cable and satellite operators in exchange for a per-subscriber fee. Sport TV holds a license to distribute most league matches of Portugal's leading football league and certain other European football leagues through 2004. Until November 2003, 33.33% of Sport TV was owned by each of PT Conteúdos, PPTV and Rádio Televisão Portuguesa, S.A., or RTP, the Portuguese state television operator. In November 2003, PT Multimedia entered into an agreement to purchase, through PT Conteúdos, an additional 16.67% stake in Sport TV from RTP for €16.3 million, thereby increasing its ownership in Sport TV to 50%. The remaining 50% is now held by PPTV. The purchase was completed in April 2004. The agreement guarantees Sport TV exclusive broadcasting rights to Portuguese football league matches from 2004 through 2008.

PT Conteúdos also holds PT Multimedia's 40% interest in Lisboa TV (the owner of the live news and information channel "SIC Notícias"). See "TV Cabo", above.

PT Conteúdos is engaged in the wholesale business for content. From 2002 onwards this company has been responsible for negotiations with content producers of the acquisition of rights to carry pay TV channels and other content. It resells that content to different distribution platforms including TV Cabo's pay TV and Internet platforms, as well as those of other operators.

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PT Conteúdos sells advertising on its own channels and on others, where PT Conteúdos has acquired the right to sell advertising as part of certain content acquisition contracts entered into. PT Conteúdos also manages the sale of advertising for TV Cabo's channels in exchange for an agency fee.

Lusomundo Audiovisuais. Lusomundo Audiovisuais conducts activities in all film exhibition windows, acquiring rights for cinema, DVD, video, pay-per-view and television. It also produces its own Pay TV premium movie channels and distributes DVDs, videos, and videogames. Lusomundo Audiovisuais has the right to distribute the following audiovisual content in Portugal:

Theatrical Exhibition: UIP (Universal, Dreamworks and Paramount), BUENA Vista International (Touchstone, Walt Disney Pictures), Spyglass, Revolution Studios and other independent producers;

Video: BVHE (Walt Disney), Paramount, Spyglass, Revolution Studios and other independent producers; and

Videogames: Sony Playstation (contract expired in April 2004).

Lusomundo Cinemas. Lusomundo Cinemas is the market leader in Portuguese cinema exhibition, with 145 theaters. It also has 115 screens in Spain through its 33% stake in Warner Lusomundo Sogecable.

Lusomundo Media. Through Global Notícias, Publicações, S.A., Lusomundo Media owns several newspapers and magazines in Portugal, such as:

"Jornal de Notícias", one of Portugal's most popular daily newspapers, with an average daily circulation of approximately 102,527 in 2003;

"Diário de Notícias", one of Portugal's leading daily newspapers, with an average daily circulation of approximately 47,131 in 2003;

"24 Horas", a daily tabloid newspaper, and "Tal & Qual", a weekly tabloid newspaper;

regional newspapers, including "Açoreano Oriental", "Diário de Notícias da Madeira", "Jornal do Fundão" and "Jornal Tribuna de Macau"; and

6 magazine titles, including "Notícias Magazine", "Grande Reportagem", "Volta ao Mundo", "Evasões", "Playstation 2" and "National Geographic Magazine".

Lusomundo Media also provides radio content and programming and owns "TSF", Portugal's most popular news radio station. As of December 31, 2003, "TSF" had approximately 500 thousand listeners on a daily basis and an approximately 27% share of the total radio advertising market in Portugal.

Lusomundo Media also has equity stakes in instrumental companies that provide, among other things, printing and distribution services to Lusomundo Media companies.

International Investments

Investments in Brazil

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We have certain additional investments in Brazil, in addition to our investment in Vivo described above, including, most significantly, PrimeSys, a provider of telecommunications business solutions to large corporate clients, and Mobitel, a call center company.

PrimeSys. PrimeSys is seeking to provide a full spectrum of services to assist businesses in integrating Internet and IT services into their current business operations. Such services include outsourcing of both communications and IT services as well as high margin services such as web enabling and systems integration.

On December 13, 2000, we entered into an agreement with Unibanco-União de Bancos Brasileiros, S.A., or Unibanco, and Banco Bradesco, S.A. Pursuant to this agreement, Unibanco and Banco Bradesco transferred their private telecommunications networks to a new company called BUS. The initial stages of the project were launched in January 2001. On June 29, 2001 PrimeSys acquired a 73% economic interest in BUS by acquiring 19.9% of the voting shares and 100% of the non-voting shares of BUS, and increased its ownership to 100% of voting shares in June 2002.

Mobitel. Mobitel provides call center services in Brazil primarily to Vivo's subsidiaries, which represent more than 80% of its client base.

Investments in Africa

We have investments in Cabo Verde Telecom, a global telecommunications operator in the Cabo Verde Islands, and in certain other mobile operators in Morocco, Angola and Botswana.

Cabo Verde Telecom. We own 40% of the share capital of Cabo Verde Telecom. Cabo Verde Telecom has the exclusive right to provide fixed, mobile and data services under the terms of its concession, and is the only provider of mobile services using GSM technology, in the Cabo Verde Islands, a Portuguese- speaking country off the coast of West Africa.

Medi Telecom in Morocco. In August 1999, Medi Telecom, a consortium made up of Portugal Telecom, Telefónica Móviles and certain Moroccan entities, bid for and won a license to operate a GSM mobile network in Morocco. This was the second such license issued by the Moroccan government. The license fee was 9.0 billion Moroccan dirhams (€929 million). Medi Telecom entered into a €1 billion project financing facility. We initially held 34.5% of Medi Telecom, having invested approximately €166 million, but in January 2000 we sold 4% of our interest in compliance with a condition of the bid process for the same license. At the end of 2002, following a capital increase, Portugal Telecom raised its equity share to 31.34%, equal to Telefónica's position. During the fourth quarter of 2003, following another share capital increase, Portugal Telecom raised its equity share to 32.18%. Medi Telecom began operations at the end of March 2000. By the end of 2003, it had 2,060 thousand subscribers, which corresponds with an estimated market share of approximately 43.4%. Approximately 93.7% of its active mobile telephone cards are prepaid. We are managing the operations of Medi Telecom jointly with Telefónica Móviles.

Unitel in Angola. At the end of 2000, we acquired 25% of the share capital of Unitel, a GSM mobile operator in Angola. Unitel's other shareholders are Sonangol, which holds 25%, and local partners, which hold 50%, of the share capital of Unitel. We are the operational manager of the venture, which began operations in Luanda in April 2001. As of December 31, 2003, Unitel had 230 thousand subscribers of which 99% were prepaid cards.

Mascom Wireless in Botswana. We manage the operations of, and have a 50.01% interest in, Mascom Wireless, an international consortium that offers GSM services in Botswana. On July 7, 2003, we entered into an agreement to sell our 50.01% interest in Mascom Wireless for 250 million Botswana Pulas (approximately €46 million). We have already received an initial payment of 200 Botswana Pulas (approximately €41 million), which is being held in escrow pending regulatory approval of completion of the transaction. Once the sale is complete, we intend to continue to provide consulting services to Mascom Wireless' management within the scope of the existing Management Agreement.

Mascom Wireless was the first operator of GSM services in Botswana and is currently the market leader with an estimated 71% market share as of December 2003. Mascom had approximately 330 thousand subscribers, and it had gross operating revenues of €64.7 million in 2003, €54 million in 2002 and €53 million in 2001. We accounted for Mascom Wireless on an equity basis until the end of 1999, assuming an interest of 40%. Since January 1, 2000, we have fully consolidated its financial results.

Investments in Asia

We have certain investments in Asia, including, most significantly, our investment in CTM.

CTM. We have a 25% interest in Companhia de Telecomunicações de Macau, or CTM, the exclusive provider of fixed line services and a provider of mobile telephone services in Macau. Macau, an enclave situated near Hong Kong on the coast of the Guangzhou Province, China, was a territory administered by the Portuguese government until December 1999 when its administration was transferred to the People's Republic of China. The other shareholders of CTM are Cable & Wireless plc and CITIC Pacific.

At December 31, 2003, CTM had 175 thousand fixed main lines in service. This figure represents approximately 37 fixed main lines per 100 inhabitants. CTM's mobile telephone services are growing rapidly, with 208 thousand active mobile telephone cards at December 31, 2003 and 44 active mobile telephone cards per 100 inhabitants. CTM uses GSM digital mobile technology. In December 1999, CTM entered into a new concession that will be valid until the end of December 2011.

Instrumental Companies

As part of our reorganization, in December 1999, we created PT Sistemas de Informação, an information systems support unit to which we have transferred the data centers, information systems and information technology activities of our business units. PT Sistemas de Informação provides integrated information systems and information technology services to our business units, as well as to our existing and new customers. We now hold 100% of the share capital of PT Sistemas de Informação, having acquired the remaining 5% held by ICM in 2003. PT Sistemas de Informação has subcontracted certain information technology services to DCSI-Dados, Computadores e Soluções Informáticas, or DCSI, an information technology company controlled by IBM.

In July 1999 we created Portugal Telecom Inovação, S.A., or PT Inovação, to focus on research and development of innovative technological solutions for the telecommunications market.

In February 2003, we created PT Pro, S.A., or PT Pro, to aggregate all our back office activities in Portugal. PT Pro will take advantage of economies of scale and process alignments throughout our group to reduce costs in back office activities. PT Pro will also allow for a reduction of the execution risk of our financial reporting function through standardization of processes and application of best practices.

In May 2003, we created PT Compras, S.A., or PT Compras, and we transferred our newly created central purchasing unit to this company. PT Compras will optimize our purchasing function on an integrated basis. Taking advantage of scale and specialization, we expect PT Compras to increase pressure in reducing suppliers' prices and to improve the levels of quality and service. We believe that PT Compras will be a significant driver in creating competitive advantages for Portugal Telecom.

Strategic Alliances

We have summarized below our principal existing and planned alliances and joint ventures.

Alliance with Telefónica. In 1997, we entered into a cooperation agreement with Telefónica. This agreement focused principally on cooperation in international investments, particularly in Latin America. In 1998 we acquired interests, together with Telefónica, in Brazil. See "*Brazilian Mobile Business*." In 1999 we commenced operations with Telefónica in Morocco. See "*International Investments Medi Telecom in Morocco*".

On January 23, 2001, we entered into a strategic agreement with Telefónica to create a mobile joint venture company that would aggregate all our Brazilian mobile assets with the Brazilian assets of Telefónica Móviles, the mobile subsidiary of Telefónica, to the extent permitted under Brazilian law. On

December 27, 2002, we and Telefónica transferred all of our respective interests in Brazilian mobile services companies to the joint venture, named Brasilcel and operating under the brand name Vivo since April 2003, with its head office in the Netherlands. We hold our interest in Vivo through PT Móveis and Telefónica holds its interest through Telefónica Móviles. Our agreements governing the ownership and management of Vivo have been entered into by those entities. We have discussed the benefits we expect from the joint venture with Telefónica and the reasons for entering into it above under "*Brazilian Mobile Business*".

We have appointed the Chief Executive Officer and Telefónica has appointed the Chief Financial Officer of Vivo. We manage Vivo on an equal basis with Telefónica and appoint ten of the twenty members of its board of directors, including the Vice-Chairman. Five of each party's ten directors must be resident in the Netherlands. In the event that either our or Telefónica's economic and voting interest is diluted below 50%, but not lower than 40%, due to a capital increase, the diluted party can re-build its interest to 50% within 12 months from the date of dilution. During such period, Vivo would be managed on an equal basis. We can maintain our share ownership percentage by contributing with cash or liquid assets. Should the percentage of the share capital in Vivo that we or Telefónica hold fall below 40% and remain below 40% for six consecutive months thereafter, our respective numbers of directors on the board will be changed to reflect our proportional shareholdings and the diluted shareholder will lose its right to appoint the CEO or CFO, as applicable.

As long as both parties have equal voting rights, the decisions of the board of directors shall be made by mutual agreement of the parties and will accordingly require the vote of at least one director appointed by each party. The joint venture agreement specifies that important decisions will be made by the affirmative vote of at least eleven members of the board of directors. If a deadlock over an important issue in the decision-making of Vivo cannot be resolved by the chairmen and CEOs of us and Telefónica, then the issue will be settled by reference to a committee of third party "wise persons". Alternatively, if the parties so agree, the interests contributed by the companies to Vivo will be returned and any subsequent interests acquired by Vivo will be divided according to the agreement of the parties or by arbitration.

Potential acquisitions of wireless and mobile telephone operators in Brazil may be pursued by Vivo or by us or Telefónica and subsequently contributed to Vivo. New acquisitions by Vivo require the approval of a majority of the board of directors of Vivo. If either we or Telefónica acquire a mobile operator in Brazil, the acquiring party must offer the right to a 50% participation in the acquisition to the other party.

In the event of a change of control of either us or Telefónica, the unaffected party shall have the right to sell the shares that it owns in Vivo to the affected party at a value determined pursuant to an independent appraisal. In addition, if we are diluted to below a 40% economic and voting interest in Vivo and fail to increase our interest to 40% within a six-month period, we will have the right to sell our interest in Vivo to Telefónica within one year from the expiration of the applicable six-month period at a price to be determined by a third party.

If either party wishes or is required to transfer all or part of its equity interest in Vivo to a third party, the non-transferring party will have the right to purchase the equity interest on the same terms and conditions offered by the third party.

As part of our initial agreement with Telefónica, we acquired 1.0% of Telefónica's share capital and Telefónica acquired 3.5% of our share capital. We and Telefónica also gave each other a right of first refusal on any transfer of our respective interests. In addition, a member of our board who is an executive officer is serving on Telefónica's board as a non-executive director and a member of Telefónica's board who is an executive officer is serving on our board as a non-executive director. Under the terms of our strategic agreement with Telefónica, we may acquire up to 1.5% of Telefónica's share capital, and Telefónica may increase its ownership interest in our share capital up to 10%. On

April 20, 2004, Telefónica increased its interest in our share capital to 8.17%. Neither party controls the operations or management of the other.

Alliance with Banco Espírito Santo and Caixa Geral de Depósitos. In April 2000, we signed a strategic partnership agreement with the Banco Espírito Santo group, or BES, and Caixa Geral de Depósitos, or Caixa, to develop "new economy" initiatives. Pursuant to this agreement, BES increased its stake in Portugal Telecom to 6% of Portugal Telecom's share capital, and in August 2000 we acquired a stake in BES of 3% of its share capital. As of December 31, 2003, BES owned 9.75% of Portugal Telecom's share capital. In accordance with this arrangement, an executive officer of BES serves as a non-executive member of Portugal Telecom's board of directors. An executive member of Portugal Telecom's board of directors also serves as a non-executive member of the board of directors of BES.

Under this strategic partnership agreement, we launched various initiatives in business-to-consumer and business-to-business e-commerce and new mobile service areas in business-to consumer and e-finance, business-to-business and M-commerce and payment services.

Properties

Our principal properties consist of buildings and telecommunications installations. These include various sizes of exchanges, transmission equipment, cable networks, base stations for mobile networks and equipment for radio communications. They are located throughout Portugal and internationally.

We own several office buildings in Portugal. Our main proprietary office space is located at the following addresses:

R. Gonçalves Cristóvão, nº 155, Porto, Portugal (15,116 square meters);

R. General Humberto Delgado, 342/368, Coimbra, Portugal (11,785 square meters);

R. Andrade Corvo, 10/14, Lisboa, Portugal (10,300 square meters);

Av. da Liberdade, 266 and R. Rodrigues Sampaio, 111, Lisboa, Portugal (10,057 square meters); and

R. D. Estefânia 78/82, Lisboa, Portugal (4,441 square meters).

We also have some leased offices, which are located at the following addresses:

Av. Fontes Pereira de Melo, 38/40, Lisboa, Portugal (61,534 square meters);

Av. Álvaro Pais, 2, Lisboa, Portugal (31,800 square meters);

Parque da Ciência Oeiras, Lt 35, Taguspark, Portugal (27,800 square meters);

R. Tenente Valadim, 431/453, Porto, Portugal (21,400 square meters);

R. Afonso Costa, 4, Lisboa, Portugal (13,266 square meters); and

R. Entrecampos, 28, Lisboa, Portugal (7,120 square meters).

The cable television infrastructure that TV Cabo's regional subsidiaries have installed and operate may be subject to reversion or transfer to third parties without compensation when the authorizations granted expire or are terminated. See " *Regulation Portugal Summary of Our Concession and Existing Licenses*".

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We have registered our important trademarks, such as "Portugal Telecom," "PT Comunicações," "TV Cabo," "PT Prime," "TMN," "PT Multimedia," "PT Multimedia.com," "Telepac" and their related logos, in Portugal. We have also applied for a European Community trademark for "Portugal Telecom" and our logo. Telesp Celular has registered its important trademarks in Brazil. Brasilcel,

through one of its Brazilian subsidiaries, is in the process of registering the trademark "Vivo" in Brazil, Portugal and Spain. Trademarks registered in Brazil may be subject to less legal protection in Brazil than registered trademarks in Portugal or the United States. We do not own any registered patents or copyrights which are material to our business as a whole.

Competition

We now face substantial and increasing competition. The Portuguese telecommunications sector has been open fully to competition since January 1, 2000. We have competitors able to compete with us in each of our service areas. In response to the competition we are already experiencing and in anticipation of intensified competition, we are pursuing a range of strategic initiatives. Through these, we intend to reposition, modernize and prepare ourselves for the challenging new environment in which we operate.

Competition Facing Our Wireline Business

Since January 1, 2000, we no longer have the exclusive right to provide domestic and international public switched fixed line telephone services or to install and operate the related telecommunications networks in Portugal.

Retail. Our wireline business faces increasingly strong competition from new fixed-line operators as well as from mobile telephone service providers, including our own mobile service provider, TMN. The number of subscribers to mobile services in Portugal now outnumbers the number of wireline lines in Portugal. At the end of 2003, there were approximately 89.8 active mobile telephone cards per 100 inhabitants in the Portuguese market. This growth comes as more residential subscribers add mobile lines for family members and as businesses add mobile cards for their employees. Vodafone Portugal and Optimus are already marketing their mobile services as an alternative to our wireline telephone services. We compete with them for market share. Mobile telephone services provided by TMN, Vodafone Portugal and Optimus have been growing strongly. Through TMN, we have benefited from the rapid growth of mobile services.

Vodafone Portugal and Optimus have major shareholders that can provide them with substantial resources. As well as strengthening their position in the mobile telephone market, this may enable them to compete directly and aggressively with our fixed-line telephone services. See "*Competition Facing TMN in Portugal*". Optimus and Vodafone Portugal already offer direct access through fixed wireless access technology.

At December 31, 2003, according to ANACOM figures, PT Comunicações, which provides retail services as part of our wireline business, had an estimated 94% market share of lines. At December 31, 2003, according to ANACOM figures and our estimates, our wireline business had an estimated 88% market share of total outgoing traffic, a decrease of 2 percentage points from December 31, 2002, and an estimated 89% market share of domestic outgoing traffic, a decrease of 2 percentage points from December 31, 2002.

The main competitors in the wireline voice market include Oni Telecom Infocomunicações, S.A. (owned by Electricidade de Portugal, Banco Comercial Português and Brisa Autoestradas Portugal), Novis (owned by Sonae and France Telecom), Tele 2, Jazztel, Vodafone Portugal and the international competitor Global One. Jazztel, Vodafone Portugal and Global One are offering services mainly to small and medium-sized enterprises and corporate segments. Jazztel is constructing fiber rings in Lisbon and Oporto. It holds a license to offer fixed wireless access local loop services. As Jazztel rolls out its service offering, we expect it to be a significant source of competition for the provision of wireline telephone services to small and medium-sized enterprises. Sonae, the leading Portuguese retail group and a major Portuguese enterprise, in joint venture with France Telecom, formed Novis, the operator for fixed communications, and the cellular operator Optimus. All of the new entrants have

focused on providing their customers national and international services over their networks without direct interconnection. These customers must still connect to our competitors' services through our fixed lines.

The cable operator, Cabovisão, offers a package of Internet, cable TV and voice services to the residential segment. Cabovisão has attracted some of our local customer market and may continue to do so.

The development of fixed wireless access local loop infrastructure represents a significant competitive challenge to our local loop infrastructure, because it provides an alternative to our local loop direct connections to customers. According to ANACOM, 251 fixed wireless access licenses were awarded to companies in Portugal as of December 31, 2003. The fixed wireless access local loop infrastructure that is being developed under these licenses is used to offer voice services in competition with our fixed-line telephone services.

Measures such as call-by-call selection (introduced on January 1, 2000) and carrier pre-selection (introduced on October 1, 2000), as well as number portability (introduced on July 1, 2001), make it easier for our competitors to attract our customers to their services. At December 31, 2003, we estimate that there were approximately 356 thousand lines in pre-selection.

We lose revenues from our international telephone services because we no longer have the exclusive right to provide fixed-line telephone services, and large telecommunications users lease lines through which they connect to networks outside Portugal. At December 31, 2003, according to ANACOM data and our estimates, our wireline business had an estimated 73.9% market share of international traffic, a decrease of 2.8 percentage points from December 31, 2002. In addition, we are losing revenues from our international telephone services as mobile operators establish direct international interconnections with mobile or fixed-line networks outside of Portugal, enabling them to offer international telephone services without using our network. We face indirect competition in international fixed-line telephone services from calling cards and rerouting of calls by other international operators. Together with falling international call prices worldwide, these factors put pressure on us to reduce international fixed-line telephone prices.

In response to full competition, we have been lowering the prices of our wireline telephone services. In 2003, prices reduced by 9.5% for regional calls and 13.1% for domestic long distance on average, compared with 2002. International call rates increased on average by 3.4% in 2003, compared to 2002. In 2002, we maintained the aggregate nominal prices of our regulated basket of services. We believe our price structure is now competitive and that we are meeting the challenge of full competition.

The overall effect of full competition partly depends on the prices that other mobile and wireline network operators pay us to interconnect with our network. Portuguese law requires us to lease lines to our competitors. It also obliges us to interconnect our network with our competitors' networks or lines leased by them. Our interconnection rates are subject to regulatory review. See "*Regulation Pricing of Wireline Services Interconnection Prices*". If ANACOM intervenes in the future to set interconnection prices at low levels, we believe new entrants to the Portuguese market would have a competitive advantage. New entrants and resellers of lines leased from existing operators have made very rapid inroads into other EU telecommunications markets that have also opened up to full competition.

Wholesale. Mobile operators are establishing direct international interconnections with mobile or wireline operators outside Portugal, enabling them to offer international telephone services without using our network. This is reducing our wholesale revenues generated from connecting mobile operators in Portugal to operators abroad.

Our interconnection business faces more direct competition now that other operators may install and operate their own public wireline telephone networks. Mobile and wireline networks, which are our interconnection customers, can interconnect with these new networks rather than with ours. Other competitors may also establish local networks using other technologies such as local radio systems, fiber optic technologies and new mobile systems that may be used to complete calls which are currently made to our subscribers. For instance, Refer, the owner of the Portuguese national railway infrastructure, and Águas de Portugal, a Portuguese state holding company with interests in water distribution companies, have formed Netrail, a fiber optic network company.

Data and Corporate. We face significant competition from several operators. Our principal data communications and business solutions competitors include companies associated with Oni Telecom, Novis, Jazztel, Vodafone Portugal and other international operators, such as Global One, Colt, Equant and KPN Qwest. These companies compete with us in providing data communications, voice and Internet services to business customers. Such service providers can use lines leased from us or their own networks. This market is now highly competitive. These customers tend to have large volumes of traffic, particularly international and long distance.

Our competitors may use satellite-based networks, the infrastructure of public network operators, leased lines and their own infrastructure to offer telecommunications services to customers. These are all alternatives to leasing lines from us for data communications. As a result of competition, we have reduced our prices for leased lines and focused on value-added solutions based on Internet Protocol Virtual Private Networks, or IP VPN, to establish managed internal voice and data transmission networks to our customers, as well as data center services.

Competition Facing TMN in Portugal

TMN competes with Vodafone Portugal and Optimus, the two other mobile operators licensed to provide mobile telephone services in Portugal. According to figures from ANACOM, at the end of 2003, in terms of the number of active mobile telephone cards in the Portuguese market, TMN had a 52.3% market share.

Optimus' growth since it entered the market in September 1998 has been partly a result of the growth in the overall mobile market. TMN's market share was approximately 50.5% of the number of active mobile telephone cards at year-end 1997, before Optimus began to offer services in 1998. Vodafone Portugal had approximately 49.5% of the market at that time. TMN's market share initially dropped when Optimus began to offer services. Since the end of 1998, however, TMN has made maintaining its market share a priority. As a result of competitive pricing strategies, quality of service, innovative services and technology and excellent subscriber care, it has sustained its market share of new mobile subscribers.

Price competition has increased appreciably since Optimus entered the Portuguese mobile telephone market in September 1998. Both TMN and Vodafone Portugal have lowered prices in response to price reductions by Optimus.

Vodafone Portugal and Optimus each have major shareholders that could provide them with substantial resources to compete aggressively against us in the Portuguese mobile telephone market. Vodafone Group plc, which was already Vodafone Portugal's controlling shareholder, acquired the remainder of its share capital during 2003. Sonae (one of Portugal's largest groups with a leading position in the retail business in Portugal) and Orange (a subsidiary of France Telecom) are the major shareholders in Optimus. We expect Vodafone and France Telecom to use Vodafone Portugal and Optimus, respectively, as vehicles to market their own services in the Portuguese market.

Competition is increasing in the mobile services sector in Portugal as TMN and its competitors develop new services. The Portuguese government awarded four licenses to provide third generation mobile services in December 2000. Each of TMN, Vodafone Portugal and Optimus has received one of these licenses. The fourth license was awarded to Oniway, a subsidiary of Oni Solutions and a new entrant in the Portuguese mobile market. However, Oniway decided not to participate in the provision of third generation mobile services, and, as a result, the Portuguese government repealed the license granted to Oniway by ministerial order on January 13, 2003. The other three recipients of third generation licenses, including TMN, requested that the additional frequency that had been allocated to the new entrant be reallocated to them. This request was granted by a special ministerial order in January 2003. See " *Regulation Portugal Third Generation Mobile Services Licenses*".

Competition Facing Vivo in Brazil

Throughout 2003, Vivo faced increasing competition not only from its established competitors, but also from new operators in some of the markets where Vivo operates. As of December 31, 2003, Vivo had 20.7 million subscribers, corresponding to a market share of 56.2% in its areas of operation, compared with 60.8% in 2002. Vivo's major competitors are Claro (Telecom Américas), Telecom Itália Mobiles and Oi.

Telesp Celular competed with two mobile operators in the state of São Paulo in 2003: Claro and Telecom Itália Mobiles. BCP and Tess, two former competitors of Telesp Celular, which began offering services in their respective areas of the state of São Paulo in 1998, were acquired by Telecom Américas and were merged into Claro in 2003. In February 2002, Telecom Itália Mobiles acquired a band D license for the entire state of São Paulo. In September 2002, Telecom Itália Mobiles began operations in São Paulo using the GSM/GPRS technology.

On December 10, 2002, Telesp Celular converted its concessions to new SMP licenses. The distribution of new SMP licenses is likely to increase the competitiveness of the mobile market in which Telesp Celular operates as well as in the other areas where Vivo operates.

Telesp Celular also competes with other wireless telecommunications services, such as digital trunking and paging services, which are widely used in Brazil.

Telesp Celular also competes for subscribers with wireline telephone service providers. Some existing and potential subscribers may shift to wireline services for a number of reasons, including price, if the availability of wireline services and the quality of the service improve. The main wireline service provider in São Paulo state is Telefónica, through Telesp Fixa.

In 2003, Global Telecom competed with Claro and Telecom Itália Mobiles in the states of Paraná and Santa Catarina. In 2003, Tele Celular Sul, Global Telecom's previous competitor, was acquired by Telecom Itália Mobiles. In February 2002, Telecom Américas, which controls Claro, acquired a band D license and Brasil Telecom (a wireline operator) acquired a band E license, for the states of Paraná and Santa Catarina. During the second half of 2002, Claro began operations in Paraná and Santa Catarina using the GSM/GPRS technology. Brasil Telecom has announced plans to begin operations during 2004 in the states of Paraná and Santa Catarina using GSM/GPRS technology.

Tele Sudeste competed with three mobile operators in the states of Rio de Janeiro and Espírito Santo in 2003: Claro, Oi, which is controlled by Telemar (a wireline operator), and Telecom Itália Mobiles. Oi and Telecom Itália Mobiles launched their operations during the second half of 2002. In 2003, ATL, Tele Sudeste's previous competitor, was acquired by Claro. In February 2002, Telecom Itália Mobiles acquired a band D license and Oi a band E license for the states of Rio de Janeiro and Espírito Santo. During the second half of 2002, Telecom Itália Mobiles and Oi began operations in Rio de Janeiro and Espírito Santo using the GSM/GPRS technology.

Tele Leste competed with three mobile operators in the states of Bahia and Sergipe in 2003: Claro, Oi and Telecom Itália Mobiles. Oi and Telecom Itália Mobiles launched their operations during the second half of 2002. In 2003, Maxtel, Tele Leste's previous competitor, was acquired by Telecom Itália Mobiles. In February 2002, Telecom Américas, which controls Claro, acquired a band D license and Oi a band E license for the states of Bahia and Sergipe. During the second half of 2002, Claro and Oi began operations in Bahia and Sergipe using the GSM/GPRS technology.

CRT Celular competed with two mobile operators in the state of Rio Grande do Sul in 2003: Claro and Telecom Itália Mobiles. In 2003, Telet, CRT Celular's previous competitor, was acquired by Claro. In February 2002, Telecom Itália Mobiles acquired a band D license and Brasil Telecom a band E license for the state of Rio Grande do Sul. During the second half of 2002, Telecom Itália Mobiles began operations in Rio Grande do Sul using the GSM/GPRS technology. Brasil Telecom has announced plans to begin operations during 2004 in the state of Rio Grande do Sul using GSM/GPRS technology.

TCO competed with two mobile operators in the states of Acre, Rondônia, Mato Grosso, Goiás, Mato Grosso do Sul, Tocantins and in the Federal District in 2003: Claro and Telecom Itália Mobiles. In 2003, Americhel, TCO's previous competitor, was acquired by Claro. In February 2002, Telecom Itália Mobiles acquired a band D license and Brasil Telecom a band E license for the states of Acre, Rondônia, Mato Grosso, Goiás, Mato Grosso do Sul, Tocantins and the Federal District. During the second half of 2002, Telecom Itália Mobiles began operations in these states using the GSM/GPRS technology. Brasil Telecom has announced plans to begin operations during 2004 in these states using GSM/GPRS technology. TCO also competed with four mobile operators in the states of Amazonas, Pará, Maranhão, Roraima and Amapá in 2003: Tele Norte Celular, Oi, Claro and Telecom Itália Mobiles. In February 2002, Claro acquired a band C license, Telecom Itália Mobiles a band D license and Telemar, which controls Oi, a band E license, for the states of Amazonas, Pará, Maranhão, Roraima and Amapá. During the second half of 2002, Claro, Oi and Telecom Itália Mobiles began operations in these states using the GSM/GPRS technology.

ANATEL auctioned nine new SMP licenses, three per region, operating under band C, band D and band E. An operator that was awarded a license in the SMP auction was also granted a license to operate long distance fixed telephony, both national and international, after December 31, 2001. The band C auction was canceled due to a lack of bidders. ANATEL is analyzing the best way to allocate the relevant frequency, and a new band C auction is not expected to take place. The band D auction was successfully completed on February 13, 2001. Telemar was awarded a band D license for Region I (North and East Region, including the states of Rio de Janeiro, Minas Gerais and the states in the Northeast and North of Brazil) and Telecom Itália Mobiles was awarded a band D license for Region II (Center and South Region, including the states of Rio Grande do Sul, Santa Catarina, Paraná and the states in the Center of Brazil) and Region III (São Paulo Region, including the metropolitan area of the city of São Paulo and the rest of the state of São Paulo). The initial band E auction was held on March 13, 2001. Telecom Itália Mobiles was awarded a band E license for Region I. The auction for band E licenses in Regions II and III was postponed due to a lack of bidders. However, on January 22, 2002, ANATEL published a new invitation to bid for band E licenses in Regions II and III, as well as for band D and E licenses in four smaller regions, some of which cannot be operated by Telecom Itália Mobiles due to its ownership interests in mobile operators. This auction was scheduled to take place on March 12, 2002 but was canceled due to a lack of bidders. Another auction took place in November 2002, and Brasil Telecom received three of the remaining licenses in the regions in which it already operated in wireline telecommunications, including the states of Paraná, Santa Catarina and Rio Grande do Sul. The licenses for four of the regions were returned by the bidders, and it is expected that they will be reauctioned by ANATEL in the future.

Competition Facing PT Multimedia's Pay TV and Cable Internet Business

Certain cable television operators are authorized to provide services in Portugal in addition to PT Multimedia's subsidiary, TV Cabo. Portuguese cable television authorizations cover different regions. TV Cabo has control over nine cable authorizations covering 125 counties in seven regions in continental Portugal and the Madeira and Azores Islands. As of the end of 2003, TV Cabo's cable television licenses covered approximately 77% of Portugal's population (not including its DTH satellite coverage). PT Multimedia's competitors operate principally in Portugal's major cities and include Cabovisão (which has control over six cable authorizations), ParfiteL (which has control over at least five cable authorizations) and TV TEL (which has control over four cable authorizations). According to ANACOM figures, we estimate that at the end of 2003, TV Cabo's competitors had approximately 15% of the total number of subscribers in the pay-TV market.

We believe the first cable television operator in any region has a competitive advantage over other operators. TV Cabo began providing services in Portugal before its competitors. TV Cabo began to provide services in Lisbon and Oporto, Portugal's largest cities, in 1995. In addition, TV Cabo has completed building most of its planned cable network.

PT Multimedia competes for advertising revenue with terrestrial television companies and other forms of media such as newspapers, magazines, radio, billboards and the Internet. It also competes with terrestrial television companies for the acquisition of programming to attract viewers. Such competition can increase program acquisition costs.

PT Multimedia competes with cable companies, such as Cabovisão, in the provision of broadband Internet services.

In August 2001, the Portuguese government granted an authorization to Plataforma de Televisão Digital Portuguesa, S.A., or PTDP, to provide digital terrestrial television services. ANACOM instructed PTDP that it must begin operations before March 1, 2003. As PTDP had difficulty complying with the instruction, ANACOM, with PTDP's agreement, proposed to the Ministry of Economy that PTDP's authorization be revoked. By order of the Minister of Economy, dated March 25, 2003 (Ministerial order 6973/2003, published on April 9, 2003), the authorization was revoked. We are not aware of any immediate plan of the government to grant an authorization to any other entity to provide digital terrestrial television services in Portugal.

Competition Facing PT Multimedia's Audiovisuals Business

In the five main sub-segments of this business segment (Film distribution, Cinema exhibition, Video distribution, Video games distribution and Distribution of rights for TV broadcasting), PT Multimedia faces competition from various entities that differ from segment to segment, as follows:

Film distribution: Filmes Castello Lopes, LNK Filmes, Columbia Tristar Warner Filmes de Portugal, Atlanta Filmes and Sociedade Distribuidora Vitora Filmes;

Cinema exhibition: Socorama Sociedade Comercial de Cinemas, Medeia Filmes, New Lineo Cinemas de Portugal, UCI Cinemas United Cinemas international and AMC;

Video distribution: LNK Filmes, Ecovideo, Universal Home Video, Warner Home Video; Castello Lopes, Selecções Readers Digest and Planeta Agostini; and

Distribution of rights for TV broadcasting: Warner Television, Columbia Television, Fox Television, Paramount Television, Buena Vista International Television, Universal Television, LNK, Ecofilmes and Castello Lopes.

In all of the activities mentioned above, except in the distribution of rights for TV broadcasting, where the free-to-air TV stations are basically supplied by the international market, Lusomundo

Audiovisuais and Lusomundo Cinemas are market leaders in Portugal in terms of the number of movie titles distributed and the number of movie theaters owned.

Competition Facing Lusomundo Media

The Portuguese market for newspapers and magazines has moved towards consolidation among the main media groups and the disappearance of independent publications. Excluding sports newspapers, Portugal has one of the lowest readership rates in Europe for newspapers and magazines.

In terms of daily newspapers, Lusomundo Media's "Jornal de Notícias" and "Diário de Notícias" have been dealing with more direct competition from "Público" (Sonae Group) and "Correio de Manhã" (Cofina Group).

The Portuguese magazine market has been particularly active in the last ten years. Lusomundo Media's current portfolio includes six magazines aimed at different audiences, as follows:

Segment	Magazine
News	"Grande Reportagem"
Travel	"Volta ao Mundo" "Evasões"
Information/technology	"Playstation2"
General interest	"National Geographic Magazine" "Notícias Magazine"

With a per issue circulation in excess of 190,000 copies, "Notícias Magazine" (distributed on Sundays with Lusomundo Media's newspapers, "Diário de Notícias", "Jornal de Notícias" and "Diário de Notícias da Madeira") is the market leader.

Other significant magazine publishers in Portugal, apart from Lusomundo Media, are Impresa (in association with the Swiss media group Edipress), Impala and Cofina.

Regulation

The telecommunications industry has traditionally been heavily regulated in most countries of the world, including Portugal and Brazil. Over the last several years, both countries (Portugal beginning in 1991 and Brazil in 1998) have substantially privatized their state-held telecommunications operators and have been opening their telecommunications markets to competition. Portugal, a member of the European Union, opened its telecommunications market to full competition as of January 1, 2000. Portugal is pursuing further EU-led initiatives aimed at increasing the competitiveness of its market. Brazil is also in the process of introducing further measures designed to increase competition. In this section, we explain the main laws and regulations in Portugal and Brazil that affect our operating companies in these two countries.

Portugal

In the increasingly competitive Portuguese telecommunications market, the regulatory measures which most affect our operations, our revenues and our costs, concern:

restrictions on the changes we may make to the prices we charge for certain wireline services;

obligations to allow our competitors to interconnect with and use our wireline network;

certain wireline services that we are obliged to provide to the public under our "universal service obligation";

measures that are intended to make it easier for our customers to migrate to our competitors' services, including carrier pre-selection, number portability and unbundling of the local loop; and

the terms of our Concession and our licenses, including the new third generation mobile license that TMN received at the end of 2000.

Law 91/97 of August 1, 1997, known as Law 91 or the Basic Law of Telecommunications, provides the legislative framework and the basis for telecommunications regulation in Portugal. This law was enacted to implement the European Commission's legal framework for the opening of the telecommunications sector in the European Union to full competition. Law 91 provided for the opening of the Portuguese telecommunications market, including public switched wireline telephone services and related infrastructure, to full competition, as of January 1, 2000. It also established the legislative framework for the transition to a fully competitive telecommunications sector in Portugal.

Law 91 requires the Portuguese government to ensure that a basic telecommunications network exists and basic telecommunications services are provided on a universal basis in Portugal. In addition, Decree Law 381-A/97, of December 30, 1997, provides that any entity can provide telecommunications networks and services if they obtain a license from or register with the Portuguese telecommunications regulator.

Our wireline business unit provides domestic and international public wireline voice telephone services in Portugal pursuant to a Concession granted in 1995. Portugal Telecom transferred this Concession to PT Comunicações. On December 11, 2002, we agreed to prepay the future rental payments due under the Concession in exchange for full ownership of the basic telecommunications network and to ensure that there will be no reversion of the assets related to the provision of Concession services to the Portuguese government in 2025. On December 27, 2002, we acquired full ownership of the basic telecommunications network for €365 million, which included the 2002 Concession rental fee in the amount of €16.6 million. Our other subsidiaries in Portugal hold licenses to provide their services, including mobile telephony, data transmission and cable television. See " *Summary of Our Concession and Existing Licenses*", below.

Law 91, our Concession and Decree Law 458/99 of November 5, 1999, which implemented the EU universal service regulation, impose on us universal service obligations in Portugal. Currently, we are the only telecommunications company in Portugal subject to these universal service obligations. See " *Universal Service Obligations*", below. Law 91 imposes on the operators of public telecommunications networks an obligation to permit the use of their networks by other network operators and service providers on terms and conditions that are determined competitively and without discrimination. It also prohibits unfair competitive acts and abuse of a dominant position by a network operator or service provider. Law 91 has been changed by Law 29/2002 of December 6, 2002, which enabled the sale of the ownership of the basic network assets to PT Comunicações on December 27, 2002. See " *Summary of Our Concession and Existing Licenses Our Wireline Concession*" and " *Item 8 Financial Information Legal Proceedings*". Law 91 also codified our right to use public rights-of-way free of municipal fees and taxes. Decree Law 458/99 (Universal Service) and Decree Law 415/98, which implemented the EU Interconnection Directive in Portugal, address the pricing mechanism and the financing procedures regarding universal service obligations. According to our new Concession Agreement, PT Comunicações should be compensated for losses if the rights-of-way regime changes.

In February 2002, the European Union agreed upon a new regulatory framework for electronic communications networks and services, consisting of five directives governing procedures, authorizations, access, universal service obligations and data protection; one decision on the availability and use of radio spectrum; and a recommendation on relevant product and service markets within the electronic communications sector subject to "ex ante" regulation in accordance with Directive 2002/21/EC of the European Parliament and Council on a common regulatory framework for electronic communications networks and services. Until the new EU framework for electronic communications

networks and services has been fully implemented in Portugal, decree laws 458/99 and 415/98, which implemented former EU directives and regulations on universal service obligations and interconnection, will continue to govern in Portugal. Law 91 was revoked on February 10, 2004, simultaneously with the enactment of Law 5/2004 adopting the new EU framework. However, until Law 5/2004 has been fully implemented in Portugal, the existing regulatory regime established by Law 91 will continue to govern.

Four of the directives that make up the new EU framework were adopted into law in Portugal on February 10, 2004 by the Portuguese Parliament and Government as Law 5/2004 and will be implemented through regulations by the Portuguese regulator, ANACOM. The fifth data protection directive is expected to be adopted into law in Portugal shortly.

The final implementation of the new EU framework will change the current regulatory framework applicable to us. The new EU directives and recommendations, which adopt competition law principles such as market dominance for the designation of significant market power and the definitions of relevant product and geographic markets which may be subject to "ex ante" regulation, will result in significant changes and refinements to the current regulatory regime applicable to us in Portugal.

Under the new regulatory regime, regulatory obligations can be imposed on operators having significant market power in any one of 18 relevant retail and wholesale markets identified by the European Commission. Since we are active in many of these markets, the new regulatory regime could result in an increase in the regulatory measures affecting our businesses and operations.

According to Articles 7, 14 and 16 of the new EU framework directive, ANACOM must analyze the 18 retail and wholesale markets and identify which electronic communications operators and service providers it considers to have significant market power in such markets in Portugal and notify the European Commission with respect to its findings.

ANACOM has started its analysis of 16 of the 18 retail and wholesale markets. ANACOM considers the PT group to have significant market power in the following: (i) retail markets access to the public telephone network at a fixed location (residential and business); publicly available local and/or national telephone services provided at a fixed location (residential and business); and publicly available international telephone services provided at a fixed location (residential and business); and (ii) wholesale markets call origination on the fixed telephone network provided at a fixed location and call termination on individual public telephone networks provided at a fixed location. ANACOM has notified the European Commission regarding its conclusions about the markets it has already analyzed.

In addition to the PT group, all other wireline operators in Portugal were determined to have significant market power in the call termination on individual public telephone networks provided at a fixed location wholesale market. Final decisions with respect to the existence of significant market power in each of the relevant markets is expected during the course of 2004.

ANACOM has not yet started the analysis of the 2 remaining wholesale markets.

In addition, certain other aspects of the former regulatory scheme, such as the basis upon which we and other operators in Portugal can use public rights of way and the rules governing access to ducts, may be subject to further review and changes, and have been opened by ANACOM to public comment. Overall, however, we believe that the new framework will permit an increasingly flexible approach to regulation as competition develops in Portugal. Until the implementation of the new EU regulatory regime at a national Portuguese level, the measures adopted under the former regulatory regime will continue to apply to us.

Regulatory Institutions

ANACOM. The Autoridade Nacional das Comunicações, or ANACOM, created in January 2001 (formerly The Instituto das Comunicações de Portugal, or ICP), is the Portuguese telecommunications

regulator. Since it commenced operations in 1989, it has been closely involved in developing the telecommunications regulatory framework in Portugal. It advises the Portuguese government on telecommunications policy and legislation and monitors compliance with concessions, licenses and permits granted to telecommunications providers in Portugal.

ANACOM is accountable to the Ministry of Economy. The Ministry of Economy retains basic responsibility for telecommunications policy in Portugal. Together with the Ministry of Finance, it has ultimate responsibility for monitoring our compliance with our Concession. It also has certain supervisory powers with respect to our activities. The Portuguese government delegated a significant number of those powers and functions to ANACOM in our Concession.

Over the past several years the Portuguese government has substantially increased the autonomy of ANACOM and allowed it to become a more effective and independent regulatory body. ANACOM acts on complaints against us by our competitors, our customers and other interested parties. It can impose fines on us if we do not meet our obligations under our Concession, including our obligations to supply public switched wireline telephone services, leased lines and other services to our competitors on a timely basis. ANACOM has, from time to time, addressed complaints against us by our competitors. However, such complaints have been resolved in a manner that has not had a material adverse effect on our businesses or operations. ANACOM's decisions are subject to possible reconsideration and can be submitted for judicial review.

EC Commission. Most of the EU competition rules have the force of law in all EU member states and therefore apply to us in Portugal. The current priority of the EC Commission is to ensure that EU member states fully and correctly implement EU requirements in national law. The EC Commission routinely monitors the status of EU member states in implementing EU directives.

The Directorate-General for Competition of the EC Commission is responsible for considering, on its own initiative as well as in response to complaints by interested parties, potential claims that our business activities or Portuguese government regulations are inconsistent with the key provisions of the Treaty of Amsterdam, also known as the EC Treaty, relating to competition in the EU. Article 81 of the treaty prohibits agreements or coordinated action between competitors that may affect trade between EU member states and have as their objective or effect the prevention, restriction or distortion of competition within the EU. Article 82 of the treaty prohibits any abuse of a market-dominating position within the EU, or a substantial part of the EU, that may affect trade between EU member states. The Directorate-General for Competition enforces these rules in cooperation with the national competition authorities. In addition, national courts have jurisdiction over violations of EU competition law. To the best of our knowledge, there are currently no material complaints relating to our activities or the regulatory framework of the Portuguese government pending before the Directorate-General for Competition.

We understand that at the end of 2001 the Directorate-General for Competition and the Directorate-General for Information Society of the European Commission requested information from the Portuguese government regarding the telecommunications rights-of-way regime in Portugal, which provides PT Comunicações with the exclusive right to use public rights-of-way free of municipalities' fees and taxes. Since we have not been party to the communications between the Directorates-General and the Portuguese government, we are unable to assess the potential outcome and implications, if any, for us, of such communications. However, Law 5/2004 establishes a new rights-of-way regime in Portugal whereby each municipality may establish a fee, up to a maximum of 0.25% of each wireline services bill, to be paid by the customers of those wireline operators whose network infrastructures are located in each such municipality. Proceedings to implement this new regime are currently in progress, but until such time as the new regime is implemented fully, the existing rights-of-way regime will continue to govern.

Autoridade da Concorrência. Our activities are also overseen by Autoridade da Concorrência (formerly Direcção Geral do Comércio e da Concorrência, or DGCC), a new agency with responsibility for enforcement of Portuguese competition law. It is also responsible for considering complaints relating to our business practices or other business arrangements. We expect the Autoridade da Concorrência to take a more active role in matters relating to pricing and to the determination of which companies have "significant market power" and the regulatory implications for such companies.

On February 10 and 11, 2004, the Autoridade da Concorrência conducted an unannounced search of the offices of PT Comunicações and PT Prime, seizing several documents, in order to investigate alleged abusive practices, including predatory pricing, price discrimination at the wholesale level, price discrimination at the retail level in the wireline telephone market and margin squeezes. The potential penalty for such practices could be as high as 10% of our turnover in the preceding fiscal year. As far as we are aware, this administrative investigation is still in a preliminary stage involving document collection and review. We expect that the next phase could involve the Autoridade da Concorrência either (i) requesting that we provide them with additional information regarding the documents they seized in February 2004 or (ii) formally charging us with the alleged abusive practices, which would result in an administrative proceeding in which we would defend our position before the competition authority. If we were unsuccessful in our defense, the competition authority could issue a fine in connection with such abuses. We are permitted under Portuguese law to appeal any adverse decision of the Autoridade da Concorrência to the Commerce Court. To our knowledge, the Autoridade da Concorrência has not yet reached any decision on his matter. See *"Item 3 Key Information Risk Factors Regulatory Investigations and Litigation May Lead to Fines or Other Penalties"* and *"Item 8 Financial Information Legal Proceedings Regulatory Proceedings"*.

To our knowledge, there are also several other complaints relating to our activities pending before the Autoridade da Concorrência, including complaints against: (i) Telepac regarding alleged anti-competitive practices in the broadband Internet market; (ii) TV Cabo and Sport TV by TV TEL for alleged refusal to supply advertising space; (iii) TMN by Optimus for alleged abuse of dominant position in the call termination market; (iv) "Jornal de Notícias" for alleged predatory pricing and price discrimination regarding regional advertising; and (v) PT Comunicações for alleged anti-competitive practices in the public market. The Autoridade da Concorrência has initiated requests for information with respect to these complaints.

Pricing of Wireline Services

Decree Law 458/99 required that ANACOM, DGCC and the provider or providers of the universal service in Portugal enter into a new pricing convention that governed only prices for services that we provided under universal service obligations. We are currently the only universal service provider in Portugal. See *"Universal Service Obligations"*, below. On December 30, 2002, we, ANACOM and the DGCC entered into a new pricing convention pursuant to article 11 of Decree Law 458/99. The pricing convention establishes the price regime applicable to the following universal services provided by PT Comunicações: (i) wireline services for subscribers, including traffic and subscription to analog lines within Portugal; and (ii) wireline services for public pay telephone calls made within Portugal, as well as making telephone directory and information services available. In addition, the new pricing convention governs certain obligations of PT Comunicações to provide services to retirees, low income pensioners, low consumption residential users and customers with special needs.

Under the pricing convention, the prices of universal services will be adjusted based on actual costs, and the prices charged must comply with transparency, non-discrimination and affordability principles and ensure that all users have access to such services. As a result, PT Comunicações must maintain a system of cost accounting, which will enable it to monitor the costs of the services it provides, and it must publicize current prices. For wireline subscribers, the pricing regime means that

the weighted average variation of the prices they paid for domestic services did not exceed CPI-2.75 p.p. for 2003. PT Comunicações is also obligated under the pricing convention to make available an optional pricing plan for the benefit of residential customers with low consumption and for low income pensioners.

The pricing convention expired on December 31, 2003. However, according to new Law 5/2004, until the full implementation of the new universal pricing regime, to be established in accordance with the new EU framework, the rules governing domestic prices established by the preceding pricing convention remain in effect. As a result, the average variation of domestic prices in 2004 will not exceed CPI-2.75.

On May 7, 2004, ANACOM and the Directorate General for Enterprise (DGE) approved the 2004 fixed telephone service prices proposed by PT Comunicações. These prices were set within the pricing convention, complying with the price cap of CPI-2.75%, in terms of average annual change and assuming an inflation range of 1.5% to 2.5% as per the Portuguese State Budget for 2004. The new prices will be effective as of August 2004, with a line rental increase of 2.9% and a decrease of 20.7% and 28.0% in the cost of regional and domestic long distance calls, respectively. See " *Our Businesses Wireline Business*".

Other Requirements. The regulatory framework requires PT Comunicações to submit periodic reports on quality of service and comply with the specified indicators. Penalties may occur if we do not achieve such indicators. The new pricing convention allows us to discount our prices for wireline telephone services so long as such discounts are offered on a transparent and non-discriminatory basis. In addition, we must offer economy service options to retired pensioners whose household income is less than the national minimum salary level established by the Portuguese government. As of March 2003, these economy service options are being funded by the State budget annually. We must also provide itemized billing records, white page directories and certain other facilities to certain specified categories of subscribers free of charge.

Interconnection Prices. Decree Law 415/98 of December 31, 1998, implementing the EU Interconnection Directive, which will continue to govern until Law 5/2004 is fully implemented, sets out a general framework for interconnection. We submitted our reference interconnection offer for the year 2004, which was published on March 31, 2004, to ANACOM. See " *Interconnection*", below. We also submitted our reference Internet access offer to ANACOM. See " *Interconnection Internet Access*", below.

Prices for Leased Lines. Prices for our leased lines are not subject to the pricing convention. The principles of cost-orientation, non-discrimination and transparency apply to our leased line prices, because ANACOM determined in August 2000 that we have significant market power in the provision of leased lines.

Universal Service Obligations

Law 91, our Concession and Decree Law 458/99 of November 5, 1999 impose on us universal service obligations in Portugal. These obligations include providing connection to the public telephone network at a wireline location. They also include providing access to public switched wireline telephone services, including enabling users to make and receive local, national and international telephone calls, facsimile communications and data communications. They also include providing public pay telephones, making directories available and at least one telephone directory enquiry service covering all public voice telephone subscribers' numbers.

The existing EU Interconnection Directive sets out the rules for costing and financing of universal service in a competitive environment. The EU allows EU member states to decide which operators have an obligation to provide universal service. It also describes how these states may allocate any

unfair burden that may arise as a result of the universal service obligation. However, it does limit the services that are eligible for any support payments made to the universal service provider, and it requires an incumbent telecommunications operator to justify any amounts payable by other operators to meet its net costs of meeting the universal service obligation.

Decree Law 415/98, which implemented the EU Interconnection Directive in Portugal, and Decree Law 458/99, which implemented the EU universal service regulation in Portugal, address the pricing mechanism and the financing procedures regarding the universal service obligations, as well as those who must contribute to its cost. Law 91 requires that operators of public telecommunications networks and providers of voice services must contribute to the costs of our universal service obligation. Decree Law 415/98 and Decree Law 458/99 require us to disclose to ANACOM our negative margins involved in meeting the universal service obligations. ANACOM will establish and publish the criteria for contributions to the cost of universal service. It will also determine, on an annual basis, the amounts and timing of contributions by other operators and service providers. Decree Law 458/99 also required that we, ANACOM and the DGCC enter into a new pricing convention governing the prices of services provided pursuant to the universal service obligation. As discussed above, we entered into a new pricing convention on December 30, 2002. See " *Pricing of Wireline Services*".

According to Law 5/2004, enacted to promulgate the new EU framework directive, if ANACOM determines that the provision of universal service obligations has become an excessive burden, it may compensate us accordingly. This provision of Law 5/2004 has not yet been implemented.

On August 21, 2003, ANACOM decided that PT should not be compensated for universal services provided prior to January 2001, because PT had an exclusive right to provide such services prior to that time. PT does not agree with the decision reached by ANACOM and is challenging this decision in the Lisbon administrative court. The court has not yet reached a decision on this matter.

Interconnection

The existing EU Interconnection Directive established the general conditions for interconnection among telecommunications operators in competitive markets. It guarantees the rights of new entrants to obtain interconnection from telecommunications operators with significant market power. An operator is presumed to have significant market power if it has more than a 25% share of the relevant market.

In August 2000, ANACOM declared PT Comunicações to have significant market power in the following markets:

provision of interconnection;

provision of wireline telephone networks and/or services; and

provision of leased lines.

ANACOM has declared our Portuguese mobile services subsidiary, TMN, to have significant market power in the provision of mobile networks and mobile telephone services. ANACOM also declared TMN's competitor, Vodafone Portugal, to have significant market power in these markets.

As a result of the enactment of Law 5/2004, the regulatory framework with respect to interconnection and significant market power established by the EU Interconnection Directive is in the process of being revised in Portugal. After a public comment period, ANACOM adopted a draft measure on May 7, 2004 on call origination on fixed telephone networks provided at a fixed location and call termination on individual public telephone networks provided at a fixed location and on significant market power designation in these fixed locations, which is expected to be approved by the European Commission shortly.

Internet Access. On February 21, 2001, ANACOM issued an administrative decision instructing PT Comunicações to submit a reference Internet access offer proposal changing the connection of ISPs to its wireline network from a model based on revenue sharing to one based on call origination charges and establishing maximum prices that PT Comunicações is permitted to charge ISPs for Internet access service. This administrative decision instructed PT Comunicações to implement the new billing regime by May 31, 2001. PT Comunicações published its reference Internet access offer on March 1, 2001, and since that time has modified how it accounts for revenues attributable to the interconnection of ISPs to its wireline network. We believe that PT Comunicações is in full compliance with ANACOM's administrative decision.

Under the new billing regime, two different types of billing arrangements with ISPs are possible. Under the first method of billing, PT Comunicações is required to collect revenues on behalf of ISPs from customers that use its wireline network to connect to the Internet, at a price established by the ISPs. The ISPs pay to PT Comunicações a call origination charge and the cost to PT Comunicações of invoicing customers for their minutes of usage at rates set by the ISP, if PT Comunicações is requested to invoice customers on behalf of the ISPs. PT Comunicações remits the revenues that it receives from customers to the ISPs and collects those charges that it is owed by the ISPs. When an ISP does not request that PT Comunicações invoice its customers, PT Comunicações only collects the call origination charge from the ISP. Under the second method of billing, PT Comunicações charges the ISPs a wholesale flat rate. In turn, the ISP bills its own customers for the ISP services. As discussed below in "*Item 8 Financial Information Legal Proceedings Other Legal Proceedings*", PT Comunicações has submitted a claim to the Lisbon administrative court requesting relief from ANACOM's February 2001 administrative act and contesting the legality of such act.

On March 16, 2004, ANACOM issued an administrative decision requiring that Internet access also be included in our reference interconnection offer for our wireline network. As a result, the billing arrangements between PT Comunicações and ISPs are now governed by two billing regimes: (i) the reference Internet access offer, which is based on ANACOM's administrative decision of February 21, 2001, and (ii) the reference interconnection offer for our wireline business, which is based on ANACOM's administrative decision of March 16, 2004. The primary differences between the two billing regimes relate to origination prices, the manner in which ISP infrastructures are connected to PT Comunicações' wireline network and billing arrangements. The reference interconnection offer for our wireline business has lower origination charges, involves the use of leased lines and does not require PT Comunicações to maintain billing arrangements with ISPs. The ISPs determine which billing regime will apply to their billing arrangements with PT Comunicações.

The Interconnection Framework. The existing EU Interconnection Directive requires that interconnection services be made available in a non-discriminatory manner. It also requires that operators with significant market power in the provision of wireline telephone network services or of leased lines make interconnection available by publishing a reference interconnection offer which includes interconnection price lists. Interconnection prices must be cost-based and supported by transparent accounting systems. The existing EU Interconnection Directive encourages commercial negotiations among operators but requires national regulatory authorities to establish mechanisms for effective dispute resolution.

Through Decree Law 415/98, the existing EU Interconnection Directive was implemented in Portugal. ANACOM established the basic framework for interconnection agreements. This framework is based on Law 91/97, Decree Law 415/98 and various obligations included in our Concession. All telecommunications companies with significant market power in the provision of wireline telephone networks or services, leased lines or mobile telephone networks or services must:

make interconnection access to their networks available to other network operators;

not discriminate between interconnection customers; and

provide to those requesting interconnection the information and technical specifications necessary for them to interconnect their networks.

In addition, telecommunications companies with significant market power in the provision of wireline telephone networks or services and leased lines must:

offer interconnection prices that are transparent and cost-oriented and do not discriminate between interconnection customers;

establish a reference interconnection offer; and

maintain a separate accounting system for interconnection activities.

None of the mobile operators in Portugal has been declared by ANACOM to have significant market power in the national market for interconnection, nor is any mobile operator in Portugal subject to the full interconnection regime. According to Decree Law 415/98, telecommunications companies providing mobile telephone networks and/or services with significant market power in the national market for interconnection are required to offer interconnection prices that are transparent and cost-oriented and do not discriminate between customers. They are also required to maintain a separate accounting system for interconnection activities.

The last version of the reference interconnection offer for our wireline network in 2004, which was published on March 31, 2004, sets out the overall set of services that PT Comunicações provides to other operators. It also sets forth terms and conditions, including prices, which PT Comunicações uses as a basis for providing interconnection services when requested by other operators.

Pursuant to Decree Law 415/98, ANACOM is entitled to review and modify our proposed interconnection rates and arrangements in our reference interconnection offer. ANACOM has established in Portugal an overall interconnection framework based on cost and consistent with the EU legal framework for both wireline and mobile services. We expect that convergence of interconnection rates and practices in Portugal with those in the EU will occur in a step-by-step process over the next several years.

The EC Commission generally monitors interconnection rates and practices in the EU. Through its competition directorate, the EC Commission may become involved in complaints with respect to interconnection arrangements and practices brought by new entrants against incumbent telecommunications operators. Although the EC Commission often defers to initiatives undertaken by national regulatory agencies with respect to interconnection-related matters, there can be no assurance that the EC Commission will not further investigate or become actively involved in matters concerning the establishment of interconnection arrangements in Portugal on its own initiative or in response to a complaint by another telecommunications operator.

ANACOM determined that from October 1, 2000, the ownership of fixed to mobile traffic would shift from mobile operators to wireline operators.

Number Portability and Carrier Selection

An amendment in September 1998 to the EU Interconnection Directive required member states to introduce number portability among telecommunications operators in most EU countries by January 1, 2000. Where implemented, number portability allows a subscriber at a specific location to change service providers without having to change telephone numbers. The Portuguese government adopted Decree Law 415/98, which requires us to provide number portability by a date to be set by the government member responsible for telecommunications. PT Comunicações introduced number portability for wireline services on July 1, 2001. Number portability for mobile services was introduced in January 2002.

ANACOM has required call-by-call carrier selection to be offered by us for long distance and international calls since January 1, 2000. We have been offering it for local and regional calls since January 1, 2001 and for fixed-to-mobile calls since October 1, 2000. Call-by-call carrier selection enables customers to select the carrier of their calls by dialing a code connecting them to the selected carrier.

The September 1998 amendment to the EU Interconnection Directive also required EU member states to provide that, at a minimum, all wireline network operators with significant market power offer carrier pre-selection. In Portugal, however, this obligation applies to all operators and service providers regardless of their market power. Carrier pre-selection allows customers to select the carrier that will be their default carrier. They then do not need to dial any code to connect to their selected carrier when they make their calls. ANACOM introduced interim carrier pre-selection using auto dialers on July 1, 2000 and full carrier pre-selection has been available throughout Portugal since October 15, 2000.

ANACOM also introduced call-by-call carrier selection for mobile operators, including TMN, on March 31, 2000. Following this introduction, mobile operators are required to offer call-by-call carrier selection for international calls only.

Number portability and carrier pre-selection are in the process of being revised, and a public comment period was commenced to solicit opinions on this process on March 11, 2004. We expect the results of this process to result in carrier pre-selection being revised to include non-geographical services.

Unbundling of the Local Loop

On December 18, 2000, the EC Commission approved a regulation requiring wireline network operators to make the local loop between their customers and the local switches on their networks available to competitors. This allows such competitors to connect their networks to the copper "local loop" and use it to provide their services directly to those customers without having to rely upon the network operator's relationship with the customers. According to the regulation, we are required to maintain a reference offer for unbundled access to our local loops and related facilities and to meet reasonable requests for unbundled access to our local loops and related facilities under transparent, fair and non-discriminatory conditions. Prices charged must be cost-oriented. ANACOM has announced that unbundling of the local loop should be available in Portugal in accordance with the terms of the EC regulation. Our PT Comunicações wholesale unit published its last version of the reference offer for unbundled access to our local loops on September 15, 2003. The reference offer is in accordance with terms established by ANACOM.

PT Comunicações has made available to its competitors all of the local switches for remote and physical co-location where technical and space conditions are available, 59 of which are co-located.

Internet and Related Services

Various regulatory developments may affect our Internet businesses. Portugal has adopted Decree Law 290-D/99 regarding digital signatures, which established a legal framework for electronic documents and digital signatures. This framework is a key component for developing e-commerce business. Portugal is expected to enact further measures pursuant to the EU Electronic Signature Directive, adopted in December 1999. The EU Electronic Commerce Directive, which was implemented in January 2002, further promotes the free movement of electronically provided services and commerce within the EU. For example, it requires EU member states to absolve information carriers and host-services providers from liability for the content of information transmitted over the Internet. Such provisions provide us with legal protection that is important in carrying out our business. The 1995 EU Data Protection Directive, which was implemented in Portugal in 1998, places restrictions

on the use by Internet companies of personal data stored on their networks. It is not possible at this time to ascertain the burden that data protection schemes or other self-regulation and content-monitoring requirements may impose on our Internet business.

EU Cable Television Directive

The EC Commission issued a directive on June 23, 1999 that requires member states to enact legislation directing incumbent telecommunications operators to separate their cable television and telecommunications operations into distinct legal entities. The EC Commission has indicated that further actions to reduce the potential anti-competitive effects of the joint provision of cable television and telephone infrastructures will be justified in specific cases. We believe, however, that steps already taken to operate our cable television business in Portugal through PT Multimedia, a separate legal entity that has independent shareholders, satisfy the requirements of the directive implemented in Portugal.

Licensing Framework

The EU Licensing Directive prohibits any limitation in the number of new entrants in telecommunications markets, except as required to ensure an efficient use of radio frequencies. It gives priority to general authorizations as opposed to licensing of particular activities; however, it permits national regulatory authorities to decide when licenses should be required for particular activities.

The Portuguese government approved Decree Law 381-A/97, which implemented the EU Licensing Directive. This decree law requires a separate license to:

provide public wireline telephone services;

establish and/or provide public telecommunications networks;

establish networks or provide services which require the granting of frequencies; or

conduct operations in which the operator is subject to universal service obligations, interconnection obligations or duties that derive from having significant market power.

Pursuant to the authorization directive, which is part of the new EU framework, Law 5/2004 has established a new regime, whereby an operator must have a general authorization or license in order to obtain radio spectrum or numbering resources. ANACOM is responsible for issuing regulations to implement the authorization directive. PT Comunicações' Concession will be treated as a general authorization under the new regime.

Summary of Our Concession and Existing Licenses

Our Concession is for the installation, management and operation of the infrastructure that forms part of the basic telecommunications network in Portugal (as discussed below) and the terrestrial broadcasting network in Portugal, and it permits us to provide public switched wireline telephone, packet switched data (the rights to which were transferred to our subsidiary PT Prime) on X.25 mode, leased lines and telex and telegraphy services in Portugal. We also provide mobile telephone services, cable television and data communications services under licenses granted to our subsidiaries by the Portuguese government. The subsidiaries holding the licenses are subject to separate financial reporting and other requirements.

Our Wireline Concession. The Portuguese government granted Portugal Telecom a Concession on March 20, 1995. The Concession had an initial term of 30 years, expiring in 2025, and could be renewed for successive minimum periods of 15 years by agreement between us and the Portuguese government. As part of the reorganization of our businesses, Portugal Telecom transferred the Concession to its subsidiary PT Comunicações. The Council of Ministers approved this transfer in a

Decree Law that came into effect upon publication in the Portuguese Official Journal on September 9, 2000. The Concession confers rights with respect to provision of transmission infrastructure and leased circuit services as well as wireline telephone, telex and telegraphy services in Portugal.

The Concession granted to us the right to install, manage and operate the infrastructure that forms part of the basic telecommunications network and the terrestrial broadcasting network. Some of our assets that are part of the basic telecommunications network (as defined in Portuguese legislation) were treated as being within the "public domain" under the terms of the Concession. During the term of the Concession, we were permitted to receive economic benefits from the use of public domain assets as if we owned them completely. However, such public domain assets would have reverted to the Portuguese government without compensation when the Concession expired.

On December 11, 2002, we agreed to prepay the future rental payments due under the Concession in exchange for full ownership of the basic telecommunications network and to ensure that there will be no reversion of the assets related to the provision of Concession services to the government in 2025. On December 27, 2002, PT acquired full ownership of the basic telecommunications network for €365 million, which included the 2002 Concession fee in the amount of €16.6 million. As a result of this acquisition, the terms of the Concession have been modified so that PT Comunicações no longer is obligated to pay a concession fee to the Portuguese government and ownership of the network and assets related to the Concession will not revert back to the Portuguese government in 2025. On February 17, 2003, Decree Law 31/2003 was enacted, establishing the basic regulatory principles supporting the terms of our modified Concession. On April 3, 2003, we entered into an agreement formally modifying the terms of our Concession with the Portuguese government.

The Portuguese government retains the ability to suspend or terminate our rights under the Concession. In cases of serious non-performance by us of our obligations under the Concession, the Portuguese government may, on a provisional basis, take over the development and operation of services authorized under the Concession. The Concession may also be terminated in cases of "severe, continual or insoluble" failure to perform our obligations. We believe that we have the resources to fulfill all our obligations under the Concession.

In addition, after 2010 the Portuguese government may revoke the Concession upon at least one year's notice if it deems such action to be justified in the public interest. In that event, we have the right to compensation in an amount equal to the value of the assets which constitute the infrastructure of the basic telecommunications network, including other of our assets included in our infrastructure development plan, net of depreciation and revaluation. This compensation would be payable prorated over the remaining term of the Concession. We would also be entitled to additional compensation equaling our annual average net profits for the five years prior to notification of revocation multiplied by the number of years remaining before the Concession expires. See *"Item 3 Key Information Risk Factors The Portuguese Government Could Terminate Our Wireline Concession and Licenses"*.

Our modified Concession provides that we are exempt from all taxes, fees and charges with respect to the usage of public rights-of-way for our telecommunications infrastructure. Further, Law 91/97 codified our right to use the public rights-of-way for our telecommunications infrastructure. Law 91/97 provides that we are exempt from municipal taxes and rights-of-way and other fees with respect to access to and installation and use of our telecommunications network in connection with our obligations under the Concession. Our exemption from municipal taxes prior to the enactment of Law 91/97 is being challenged in the Portuguese courts by the Municipality of Oporto. If the legal situation for rights-of-way changes, and PT Comunicações has to pay for these rights, our Concession provides that PT Comunicações should be compensated up to 2025, when the Concession expires. See *"Item 8 Financial Information Legal Proceedings Claims for Municipal Taxes and Fees"*.

Under the former terms of the Concession, we had to pay the Portuguese government a fee of up to 1% of our operating revenues from the services provided under the Concession, after certain

deductions. The concession fee for 2000 and 2001 amounted to €21.48 million and €13.20 million, respectively. The fee for 2001 includes an adjustment of the fee for 2000 that amounted to a €4.04 million reduction. As a result of the acquisition of the basic telecommunications network, the terms of the Concession have been modified so that PT Comunicações no longer is obligated to pay a concession fee to the Portuguese government, which in 2002 amounted to €16.6 million and was included in the amount paid for the acquisition of the ownership of the basic telecommunications network property. The Concession also requires us to supply telecommunications services free of charge to certain Portuguese state officials, including the President of the Republic, the President of the Parliament, the Prime Minister and the President of the Supreme Court. In 2001, 2002 and 2003, the value of such services was approximately €0.2 million, €0.1 million and €0.1 million, respectively.

We have to provide special telephone prices to certain eligible retired and pensioner Portuguese citizens. The costs of providing these special prices are directly reimbursed by the Portuguese government. In addition, we maintained in the new pricing convention the offering of supplementary discounts to certain retired and pensioner Portuguese citizens without reimbursement from the Portuguese government. The cost of such discounts was approximately €13.6 million in 2001, €12.6 million in 2002 and €10.2 million in 2003.

Under the Concession, we have to establish objectives for the development of our infrastructure and service offerings. This includes indicators of the quality of services to be complied with by us. These objectives must be defined by ANACOM.

The Concession imposes a universal service obligation on us. See "*Universal Service Obligations*", above.

The Ministry of Finance is responsible for monitoring financial issues with respect to the Concession. The Ministry of Economy is responsible for all other issues under the Concession. ANACOM is authorized to monitor and assess penalties up to a maximum of €500,000 if we fail to fulfill our obligations under the Concession or other obligations imposed by law. Disputes concerning the application and interpretation of the Concession are dealt with by arbitration.

PT Prime's Data Licenses and Registrations. PT Prime holds:

a renewable, non-exclusive license, valid until 2015, to provide wireline services;

a renewable, non-exclusive license, valid until 2015, to be a "Public Telecommunications Networks" operator; and

due to our reorganization, all the former Telepac licenses, including a data communications license, valid until 2010.

PT Prime's data communications license authorizes it to provide X.25/X.32 synchronous services and X.28 asynchronous services and other switched and non-switched data communications services, including frame relay and virtual private networks for data communications. The license also authorizes PT Prime to provide value added services such as electronic data interchange and videotext services. In addition, the license authorizes the company to construct certain networks infrastructure in connection with licensed services. With respect to packet switched data, the data communications license is valid for 30 years and renewable by right thereafter for 15-year periods, unless PT Comunicações' Concession is terminated earlier. The license is valid for 15 years for other data transmission services. Licenses have also been granted to other providers of data communications and Internet access services, including companies associated with major international telecommunications providers. However, under Decree Law 381-A/97, and in accordance with the EU licensing regime, companies are not required to have a license to provide data communications services and Internet access. Instead, it is sufficient to register their intended services with ANACOM under its service registration scheme.

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In April 1997, ANACOM granted our Telepac subsidiary a license (now held by PT Prime) to provide data communications services using satellite infrastructure.

In April 1997, ANACOM also granted our Telepac subsidiary a license (now held by PT Prime) to offer voice services to corporate networks and other closed groups of users. This license is valid for 15 years. Other providers of data communications services have also been issued licenses to provide such voice services, including Global One and Oni-Solutions.

TMN's Mobile Service Licenses. Mobile telephone service licenses are valid for 15 years and are issued by ANACOM under Decree Law 381-A/97. These licenses authorize the installation of base stations, base station controllers and control switching centers and require the licensee to construct networks capable of reaching at least 75% of Portugal's population within a specified period of time. Charges for the provision of mobile telephone services are not subject to regulation.

Through TMN, we hold a renewable, non-exclusive license to provide traditional and GSM digital mobile telephone services throughout Portugal. This license is valid until 2007 and may be renewed thereafter by authorization of the Portuguese telecommunications regulator. TMN terminated the provision of traditional analog mobile services, after being authorized by the Portuguese regulator, in 1999. Two other operators hold licenses to provide GSM digital mobile telephone services on substantially the same terms as those applicable to us. Vodafone Portugal was awarded its license in 1991. Main Road was awarded a license in 1997 and began operations through Optimus in September 1998. In addition to GSM 900 services, all three mobile service operators have been authorized since April 1998 to provide GSM 1800 services in Portugal on substantially similar terms and conditions.

We are required to comply with a number of mobile telephone service criteria. These include satisfying minimum quality standards regarding blocked call rates, network effectiveness and servicing time, and providing certain services. We are also required to provide ANACOM with monthly information about our mobile telephone operations, including the number of customers, number and average duration of calls and quarterly information about the development of infrastructure.

Third Generation Mobile Services Licenses. In 2000, ANACOM conducted a tender for four licenses for universal mobile telecommunications services, known as UMTS. UMTS services are the European version of the globally accepted technical standards for "third generation" mobile communications. UMTS constitutes a significant advance over the "second generation" digital GSM mobile services currently provided. The "first generation" services were traditional analog mobile services. The broadband capacity of the frequency spectrum to be allocated under the UMTS licenses will enable operators to supply video and Internet content to mobile handsets at higher transmission speeds.

The UMTS licenses were issued by ANACOM at the end of 2000. The licenses cover all of Portugal and are valid for 15 years. The Ministry of Economy, under direction from ANACOM, initially postponed the mandatory initiation of third generation services by license holders from January 1, 2003 to December 31, 2003. In February 2004, ANACOM issued a decision requiring the initiation of third generation services in 2004. UMTS license holders are required to initiate UMTS services commercially by June 30, 2004. On April 19, 2004, TMN launched UMTS in Portugal, with a service that allows customers to make video calls. The 3G handsets function both on GSM/GPRS and UMTS, allowing customers to use all the voice, multimedia and data services already offered by TMN. For data access exclusively, TMN also offers a 3G access card. TMN is providing initial UMTS coverage in Lisbon and Oporto, and plans to extend this coverage progressively to cover the whole of Portugal.

The license fee was €100 million per license. TMN and the other two main mobile operators in Portugal were each awarded one of these licenses at the end of 2000. One of the licenses was also

awarded to Oniway, a new entrant in the Portuguese mobile market. However, Oniway decided not to participate in the provision of third generation mobile services, and, as a result, requested that the Portuguese government repeal the license granted to it in January 2001. The Portuguese government granted this request by ministerial order on January 13, 2003. The other three recipients of third generation licenses, including TMN, requested that the additional frequency that had been allocated to Oniway be reallocated to them. This request was granted by a special ministerial order in January 2003.

The tender was for 2x15MHz of paired spectrum in the 1920-1980 MHz / 2110-2170 MHz bands and 5 MHz of non-paired spectrum in the 1900-1920 MHz band for each of the licenses. License holders are required to offer their services to:

at least 50.7% of the Portuguese population by the end of the first year;

65.7% by the end of the third year; and

77.3% by the end of the fifth year.

To ensure a competitive market develops in the new services, license holders are limited in the amounts of share capital that they and their shareholders may hold of any other license holder. Neither a license holder nor a shareholder of a license holder may hold, directly or indirectly, more than 10% of the share capital of another license holder.

TV Cabo's Cable Television Authorizations. Cable television authorizations are issued upon proposal by the member of government responsible for telecommunications and are valid for 15 years. These authorizations permit the construction of the main cable distribution centers as well as cable distribution networks. They also contain quality of service standards and, in most cases, obligations to construct networks capable of reaching 80% of the population of the authorized area. The remaining 20% of the population may request connection at an extra charge. The charges for the provision of cable television services are not subject to regulation.

Although not public domain assets and not subject to our wireline Concession, the cable television infrastructure that TV Cabo has installed and operates may be subject to reversion or transfer to third parties without compensation. Under the terms of Decree Law 241/97 infrastructure installed on the property of a governmental authority will become part of such authority's property when authorizations granted to cable television operators expire or terminate. Infrastructure installed on the property of a telecommunications operator, including us, will revert to such operator. Also, unless otherwise agreed, infrastructure installed on other property will revert to the property owner.

TV Cabo holds a total of nine renewable, non-exclusive authorizations to provide cable television services in 125 counties in continental Portugal and the Madeira and Azores Islands. Currently, certain other operators are also authorized to provide cable television services in Portugal. See "*Competition Competition Facing PT Multimedia's Pay TV and Cable Internet Business*".

Under Portuguese law, advertising on TV Cabo's stations is generally restricted on the same terms as broadcast TV. These restrictions include a ban on alcohol advertisements before 10 p.m. and a complete ban on tobacco advertisements. Advertising on premium channels cannot take up more than 10% of air-time, and advertising on basic channels cannot take up more than 15% of air-time.

Portuguese law currently permits television operators to produce and broadcast their own television programming if they have national coverage. In addition, Portuguese legislation permits the use of two-way signaling capability over cable television networks. The ability to transmit and receive signals allows the introduction of pay-per-view, home shopping and similar products in Portugal.

In 1997, the Portuguese government decided to allow competition in the provision of infrastructure to telecommunications services that are already open to competition. As a result, cable operators can

hold a public network operator license under Decree Law 381-A/97 and Decree Law 290-A/99 and cable networks may be used to provide infrastructure to providers of already liberalized services.

Brazil

General. Our Brazilian mobile businesses, the services they provide and the prices they charge are subject to regulation under the General Telecommunications Law and various administrative enactments, which regulate the services provided by Brazilian telecommunications operators.

ANATEL is the agency that regulates telecommunications under the General Telecommunications Law and the July 2001 Regulamento da Agência Nacional de Telecomunicações, known as the ANATEL Decree. ANATEL is financially autonomous, and administratively independent of the federal government. ANATEL maintains a close relationship with the Ministry of Communications. Any regulation proposed by ANATEL is subject to a period of public comment, which may include public hearings. ANATEL's actions may be challenged in the Brazilian courts under Brazilian administrative law. On November 25, 1998, ANATEL enacted "Resolution 73 Regulation of Telecommunication Services," which regulates in detail the new comprehensive framework for the provision of telecommunications services in Brazil established by the General Telecommunications Law.

Concessions and Authorizations. Prior to January 2000, ANATEL had only authorized two mobile service providers in each of the ten franchise areas under bands A and B. Band A and Band B mobile service providers, including Vivo's operating subsidiaries, were granted concessions pursuant to the *Lei Mínima*, or the Minimum Law. Each concession is a specific grant of authority to supply cellular telecommunications services, subject to certain requirements contained in the applicable list of obligations appended to each concession. If a mobile service provider wishes to offer any telecommunications service other than those authorized by its concession, it may apply to ANATEL for an authorization to offer such other services.

In accordance with the General Telecommunications Law, a concession relates to the provision of telecommunication services under the public regime, as determined by the public administration. A concession may only be granted upon a prior auction bidding process. As a result, regulatory provisions are inserted in the relevant concession agreements and the concessionaire is subject to public service principles of continuity, changeability and equal treatment of customers. Also, the government authority is entitled to direct and control the performance of the services, to apply penalties and to declare the expiration of the concession and the return of assets of the concessionaire to the government authority upon termination of the concession. Another distinctive feature is the right of the concessionaire to maintain an economic and financial balance of the concession agreement. The concession is granted for a determinate period of time and is generally renewable once.

An authorization is a permission granted by the public administration under the private regime, which may or may not be granted upon a prior auction bidding process, to the extent that the authorized party complies with the objective and subjective conditions deemed necessary for the exploitation of the relevant type of telecommunications service in the private regime. The authorization is granted for an indeterminate period of time. Under the authorization, the government will not guarantee the economic and financial balance, as guaranteed under the concession.

SMP Regulation. In November 2000, ANATEL adopted certain regulations for the issuance of new licenses, known as authorizations, to provide wireless communications services through SMP rules to compete with the then existing cellular operators in the various regions of Brazil. These regulations divided Brazil into three main regions covering the same geographic area as the concessions for the fixed-line telecommunications services. ANATEL organized auctions for three new licenses for each of those regions. The new licenses provided that the new services would be operated in the 1,800 MHz radio frequency bands, and they were denominated band C, band D and band E. These new licenses were auctioned by ANATEL and awarded during the first quarter of 2001 and at the end of 2002.

Under these new licenses, services were to be provided using the 1,800 MHz frequency, each operator would be able to provide domestic and international long distance services in its licensed area, and existing cellular service providers, as long as they do not have partnerships with fixed-line operators, as well as new entrants into the Brazilian telecommunications market, could bid for band C, band D and band E licenses. However, fixed-line operators, their controlling shareholders and affiliated cellular providers may only bid for band D and band E licenses. A cellular operator, or its controlling shareholders, cannot have geographical overlap between licenses. Current band A and band B cellular service providers could apply for an extra frequency range.

Pursuant to the SMP services regulation, each of the three main regions is divided into registration areas, or tariff areas.

Vivo's operating subsidiaries all held concessions prior to the introduction of the SMP regime. Subsequent to its introduction, they have migrated to the new SMP regime and their concessions have been converted into authorizations to use the radio frequency spectrum in their respective bands and provide services in the regions in which they operate. See " *Our Businesses Brazilian Mobile Business*". In order to migrate our services to the SMP regime, Telesp Celular and other operators owned by Vivo were required to comply with several technical and operational conditions, including, among others, the adoption of a carrier selection code for long distance calls originating from their networks.

Under the General Telecommunications Law, all mobile telecommunications service providers must provide interconnection upon the request of any other mobile or fixed-line telecommunications service provider. Until June 30, 2004, SMP service providers may either establish a price cap or freely negotiate their interconnection charges. Thereafter, the terms and conditions of interconnection will be freely negotiated between wireless and fixed-line operators, subject to compliance with regulations to be established by ANATEL relating to the traffic capacity and interconnection infrastructure that must be made available to requesting parties. If a service provider offers any party an interconnection tariff below the price cap, it must offer the same tariff to any other requesting party on a nondiscriminatory basis. If the parties cannot reach an agreement on the terms of interconnection, including with respect to the interconnection tariff, ANATEL will act as the final arbiter.

Because ANATEL considers the operators owned by Vivo to be affiliated with Telefónica, which already provides wireline long distance services in the state of São Paulo and was awarded a license to provide these services nationwide, ANATEL will not award wireline long distance licenses to the operators owned by Vivo. Though Vivo, through its operating subsidiaries, has requested that ANATEL revise the current SMP regime, there can be no assurance it will do so. Under the SMP regime, our operations will receive revenues from interconnection fees paid to us by wireline long distance operators due to long distance traffic originating and terminating on our network. However, the interconnection fees that we receive from wireline long distance operators do not fully compensate for the revenues that the operators owned by Vivo would have received from our customers for directly providing long distance services to them, and this has had a negative impact on the overall revenues of Vivo's subsidiaries.

The SMP regime may change the interconnection fees that other operators currently pay to Vivo's operators as a result of traffic originating on other networks and terminating on the mobile networks of Vivo's operators. The SMP regime permits commercial negotiation of the interconnection rates Vivo's operators charge other operators for the use of the network. Wireline operators have indicated that they may force such rates to be reduced.

The authorizations consist of two licenses one to provide mobile telecommunications services, and another to use the frequency spectrum for a period of 15 years. The frequency license is renewable for a second 15-year period upon the payment of an additional license fee.

Potential Benefits Relating to the SMP System. According to the General Telecommunications Law and Decree No. 2056/96, control of a concessionaire can only be transferred after five years from the date of privatization in the case of band A concessionaires, or the commencement of services in the case of band B concessionaires. On the other hand, under the SMP system, the authorization or control of the authorized party can be transferred through merger or incorporation of the relevant cellular mobile service provider, whether they are providing services under the band A or band B.

Obligations of Telecommunications Companies. As telecommunications service providers, the operators owned by Vivo are subject to regulations concerning quality of service and network expansion, as established in their authorizations and their original concession agreements.

Any breach by the companies of telecommunications legislation or of any obligation set forth in their authorizations may result in a fine of up to R\$50 million.

Our Brazilian mobile businesses' authorizations impose obligations to meet quality of service standards, such as the system's ability to make and receive calls, call failure rates, the network's capacity to handle peak periods, failed interconnection of calls and customer complaints. ANATEL published the method for assessing these quality service standards on April 23, 2003 (ANATEL Resolution No. 335/03).

Interconnection. Under the General Telecommunications Law, telecommunications service providers are classified as providers of either collective or restricted services. All cellular operators, including SMP service providers, are classified by ANATEL as collective service providers. All providers of collective services are required to provide interconnection upon request to any other collective service provider. The terms and conditions of interconnection are freely negotiated between parties, subject to price caps and other rules established by ANATEL. Providers must enter into interconnection agreements, regarding, among other things, tariffs, commercial conditions and technical issues, with all requesting parties on a non-discriminatory basis.

Interconnection agreements must be approved by ANATEL and may be rejected if they are contrary to the principles of free competition and the applicable regulations. If the parties cannot agree upon the terms and conditions of interconnection, ANATEL may determine terms and conditions by arbitration.

Under the SMP system, remuneration for network usage between SMP mobile operators will only be due if traffic carried in the same registration area between two networks, in a given direction, exceeds 55% of the total traffic exchanged between them. In this case, only those calls which have surpassed the 55% threshold will be subject to payment for network usage. This rule is valid until June 30, 2005. Thereafter, SMP operators will adopt full "Bill and Keep", by which no remuneration will be due for network usage among SMP networks, regardless of the amount of carried traffic.

Rate Regulation. Authorizations continue to provide for a price-cap mechanism to set and adjust rates on an annual basis. The cap is a maximum weighted average price for a package of services. The package consists of the services in Vivo's Basic Plan, including activation fees, monthly subscription fees, and certain roaming charges, which are charged for the use of mobile services under the SMP regime. The price cap is revised annually to reflect the rate of inflation as measured by the IGP-DI. However, mobile operators are able to freely set the rates for alternative service plans.

The initial price cap agreed to by ANATEL and Vivo's operating subsidiaries in their authorizations was based on the previously existing or bidding prices, and was adjusted annually on the basis of a formula contained in their authorizations. The price cap has been revised to reflect the rate of inflation as measured by the IGP-DI. The weighted average price for the entire package of services may not exceed the price cap, but the price for individual services within the package may be increased.

Other telecommunications companies that interconnect with and use Vivo's operating subsidiaries networks must pay certain fees, primarily an interconnection fee. The interconnection fee is a flat fee charged per minute of use. The interconnection fee charged by band A and band B service providers is still subject to a price cap stipulated by ANATEL. This price cap is valid until June 30, 2004, and, thereafter, the terms and conditions of interconnection must be freely negotiated among operators. ANATEL will regulate the conditions for the network usage fee negotiations. The price cap for the interconnection fee varies from company to company, on the basis of the underlying cost characteristics of each company's network. Band B service providers are subject to price caps established during the auction process for their licenses.

Competition Issues. ANATEL is required to consult with the Brazilian competition authority, Conselho Administrativo de Direito Econômico, or CADE, in carrying out certain of its responsibilities, including those related to the review of acquisitions and joint venture agreements entered into by telecommunications operators. In turn, CADE does not exercise its responsibilities without initially seeking the views of ANATEL and would not intervene with respect to any proposed acquisition or agreement affecting competition in the telecommunications sector without first seeking the views of ANATEL. Telecommunications operators must concurrently seek review from ANATEL and CADE of acquisitions and joint venture agreements.

ITEM 5 OPERATING AND FINANCIAL REVIEW AND PROSPECTS

You should read the following discussion in conjunction with our audited consolidated financial statements and the accompanying notes included elsewhere in this report. Our audited consolidated financial statements have been prepared in accordance with Portuguese GAAP, which differs in significant respects from U.S. GAAP. For a discussion of the principal differences between Portuguese GAAP and U.S. GAAP, as they relate to us, see Notes 36, 37 and 38 to our audited consolidated financial statements. All statements of income and cash flow data presented below for the years ended December 31, 2001 and 2002, and all balance sheet data as of December 31, 2001, reflect the full consolidation of TCP's results of operations with our financial results. However, as a result of the transfer of our interest in TCP to Vivo on December 27, 2002 and our acquisition of a 50% ownership interest in Vivo as of that date, our statement of income and cash flow data presented below for the year ended December 31, 2003 proportionally consolidates the financial results of Vivo and our balance sheet data as of December 31, 2002 and 2003 proportionally consolidate the financial results of Vivo.

Overview

Our Business Reorganization and Revenue Reporting Categories

Portugal Telecom, SGPS, S.A. is a group holding company. Our business operations are conducted by our subsidiaries, which are classified for financial reporting purposes according to the general type of telecommunications services provided. This current classification is different than that used in prior years. Portugal Telecom's business segments now consist of the following:

Wireline Business

Offering wireline services through PT Comunicações, PT Prime and PTM.com, as follows:
 Retail business through PT Comunicações and PT Prime, including the fixed line telecommunications service, and, through PTM.com, Internet services to residential customers;
 Wholesale business through PT Comunicações; and
 Data and corporate business through PT Comunicações and PT Prime, including data communications, leased lines, outsourcing and net solutions, and Internet business-to-business.

Domestic Mobile Business

Offering mobile services, such as voice, data and Internet-related services, through TMN.

Brazilian Mobile Business(1)

Offering mobile services, such as voice, data and Internet-related services, through Vivo and its subsidiaries, including:
 Telesp Celular, which operates in the Brazilian state of São Paulo;
 Global Telecom, which operates in the Brazilian states of Paraná and Santa Catarina(2);
 Tele Centro Oeste, which operates in the Northern and Midwestern regions of Brazil(3);
 Tele Sudeste Celular, which operates in the Brazilian states of Rio de Janeiro and Espírito Santo;
 Tele Leste Celular, which operates in the Brazilian states of Bahia and Sergipe; and
 CRT Celular, which operates in the Brazilian state of Rio Grande do Sul(4).

Multimedia Businesses

Offering multimedia and Internet-related services for the residential market through PT Multimedia and its subsidiaries, including:

Cable and satellite television through TV Cabo;
Broadband Internet access through cable modem provided by TV Cabo;
TV programming activities through PT Conteúdos and its subsidiaries and affiliates;
Cinema distribution, negotiation of cinema rights for all film exhibition windows and distribution of DVDs, videos, and videogames through Lusomundo Audiovisuais;
Cinema exhibition through Lusomundo Cinemas; and
Production and distribution of daily newspapers, news radio and a diverse range of magazines through Lusomundo Media.

Other

International investments other than Vivo, instrumental companies and the Portugal Telecom, SGPS, S.A. holding company, including:

PrimeSys, providing data communications services in Brazil;
Mobitel, providing call center services in Brazil;
Cabo Verde Telecom, providing fixed and mobile telecommunications services in the Cabo Verde Islands;
Medi Telecom, providing mobile telecommunications services in Morocco(4);
Unitel, providing mobile telecommunications services in Angola(4);
Mascom Wireless, providing mobile telecommunications services in Botswana;
CTM, providing fixed and mobile telecommunications services in Macao(4); and
Instrumental companies, including PT Sistemas de Informação, PT Inovação, PT Pro, PT Compras and PT Contact.

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- (1) During the year ended December 31, 2002, we offered mobile services in the Brazilian market through Telesp Celular, Global Telecom and Celular CRT. On December 27, 2002, PT's interest in these subsidiaries was transferred to Vivo in exchange for a 50% interest in Vivo. As a result, we now proportionally consolidate the financial results of Vivo. See *"Item 4 Information on the Company Our Businesses Brazilian Mobile Business"*.
- (2) We accounted for this investment during 2002 and 2001 using the equity method.
- (3) On April 25, 2003, TCP acquired a controlling interest in TCO. As a result, TCO's assets and liabilities as of December 31, 2003 are reflected in our consolidated balance sheet as of that date through our proportional consolidation of Vivo, and TCO's income and cash flows from May through December 2003 are reflected in our consolidated statement of income and cash flow data for the year ended December 31, 2003 through our proportional consolidation of Vivo's statement of income and cash flow data.
- (4) We account for these investments using the equity method.

We discuss and analyze our financial condition and results of operations in this section according to the new classification of our business segments used for the year ended December 31, 2003, which primarily reflects the transfer of PTM.com's results for the year ended December 31, 2003 to the wireline business segment, following PT Multimedia's sale of PTM.com to us in October 2002. For comparative purposes, financial results by business segment discussed below for the years ended December 31, 2001 and 2002 have been reclassified in order to reflect the new composition of each

business segment, except for the financial results of the Brazilian Mobile business segment for the years ended December 31, 2001 and 2002, which continue to fully consolidate TCP's results. See " *Consolidation Treatment of Vivo*" below and "Item 4 *Information on the Company Our Businesses Business Units*".

Consolidation Treatment of Vivo

On December 27, 2002, we transferred our interest in TCP to our mobile joint venture with Telefónica Móviles in Brazil, originally named Brasilcel and rebranded Vivo in April 2003. We hold a 50% interest in Vivo, which now holds directly the following investments:

the controlling interest in TCP (which holds 100% of Telesp Celular, 100% of Global Telecom since December 27, 2002 and 86.6% of the voting shares of TCO since November 18, 2003, including treasury shares owned by TCO) and a minority interest in Celular CRT Participações (which holds 100% of CRT Celular), which we used to hold; and

the controlling interest in Tele Sudeste Celular Participações (which has 100% of the mobile operators in the Brazilian states of Rio de Janeiro and Espírito Santo), Tele Leste Celular Participações (which holds 100% in the mobile operators in the Brazilian states of Bahia and Sergipe) and Celular CRT Participações, which Telefónica Móviles used to hold.

Since the transaction occurred at the end of 2002, our statement of income and cash flow data for the years ended December 31, 2002 and 2001 continued to fully consolidate the financial results of TCP, but our consolidated balance sheet at December 31, 2002, proportionally consolidated 50% of the assets and liabilities of Vivo rather than fully consolidating those of TCP. In 2003, we proportionally consolidate the financial results of Vivo in our consolidated financial results.

On April 25, 2003, TCP acquired a controlling interest in Tele Centro Oeste, or TCO, a mobile telecommunications operator in the Midwestern and Northern regions of Brazil. As a result, TCO's assets and liabilities as of December 31, 2003 are reflected in our consolidated balance sheet as of December 31, 2003 through our proportional consolidation of Vivo, and TCO's income and cash flows from May through December 2003 are reflected in our consolidated statement of income and cash flow data for the year ended December 31, 2003 through our proportional consolidation of Vivo's statement of income and cash flow data.

Changing Composition of Our Operating Revenues

The composition of our operating revenues, excluding the change in our accounting treatment of fixed-to-mobile traffic, has been changing in recent years. Mobile services, data and business solutions and multimedia services, such as Cable TV, have been growing rapidly in Portugal. Revenues from fixed line telephone services, particularly voice services, account for a decreasing share of our total operating revenues. The decrease in our fixed line telephone services revenues since 1998 reflects the migration of users from fixed line voice services to mobile voice services in Portugal, as well as price reductions. We expect these changes in the composition of our revenues to continue.

Wireline revenues accounted for 37.0% of total operating revenues in 2003, 40.7% in 2002 and 42.1% in 2001. The proportion of our total operating revenues derived from the provision of mobile telephone services in Portugal and Brazil accounted for, on a combined basis, 46.9% in 2003, 44.5% in 2002 and 44.9% in 2001. The trends above are affected by the devaluation of the Brazilian Real, since a substantial part of our mobile telephone operations are in Brazil. Had the Brazilian Real not declined in value relative to the Euro, revenues from mobile telephone services would have represented a higher proportion and wireline revenues would have represented a lower proportion of our total operating revenues in these periods. Wireline revenues currently include retail, wholesale and data and corporate revenues. The proportion of our operating revenues attributable to our wireline retail business

accounted for 24.3% in 2003, 26.3% in 2002 and 28.6% in 2001. The proportion of our operating revenues attributable to our wireline wholesale business accounted for 5.5% in 2003, 6.7% in 2002 and 6.2% in 2001. The proportion of our operating revenues attributable to our wireline data and corporate business represented 3.9% in 2003, 4.0% in 2002 and 3.5% in 2001. The proportion of our total operating revenues attributable to our multimedia businesses accounted for 11.8% in 2003, 11.1% in 2002 and 10.0% in 2001.

Changes in the Portuguese telecommunications market are causing changes to the split of revenues among business units within our group. As mobile services in Portugal are increasingly utilized as a substitute for fixed line services, these revenues migrate from the wireline business to our mobile business in Portugal, as well as to other mobile operators.

Internet Interconnection Charges

On February 21, 2001, ANACOM issued an administrative act instructing PT Comunicações to submit a reference Internet access offer proposal changing its billing structure for the interconnection of ISPs to its fixed line network from a model based on revenue sharing to one based on call origination charges and establishing maximum prices that PT Comunicações is permitted to charge ISPs for Internet interconnection service. This administrative decision instructed PT Comunicações to implement the new billing regime by May 31, 2001. PT Comunicações published its reference Internet access offer on March 1, 2001 and, since that time, has modified how it accounts for revenues attributable to the interconnection of ISPs to its fixed line network. See "*Item 4 Information on the Company Regulation Interconnection*". We believe that PT Comunicações is in full compliance with ANACOM's administrative decision.

Under the February 2001 billing regime, two different types of billing arrangements with ISPs are possible. Under the first method of billing, PT Comunicações is required to collect revenues from customers who use its fixed line network to connect to the Internet on behalf of ISPs, at a price established by the ISPs. The ISPs pay PT Comunicações a call origination charge and the cost of invoicing customers for their minutes of usage at rates set by the ISPs, if PT Comunicações is requested to invoice customers on behalf of the ISPs. PT Comunicações remits the revenues it receives from customers to the ISPs and collects those charges that it is owed by the ISPs. When an ISP does not request that PT Comunicações invoice its customers, PT Comunicações collects only the call origination charge from the ISP. Under the second method of billing, PT Comunicações charges the ISPs a wholesale flat rate. In turn, each ISP bills its own customers for the ISP services. Prior to the introduction of this billing regime, PT Comunicações established the rates for Internet interconnection and collected the revenues for such interconnection from customers who used its fixed line network to connect to the Internet. PT Comunicações retained 65% of all such revenues received and remitted 35% to the ISPs. This billing regime reduces revenues of our wireline business.

We are currently contesting the legality of the February 21, 2001 ANACOM administrative decision that governs the Internet interconnection billing regime. If PT Comunicações is successful in its initial claim, it plans to request compensation for any losses suffered in connection with the implementation of its reference Internet access offer of March 1, 2001. See "*Item 8 Financial Information Legal Proceedings*".

On March 16, 2004, ANACOM issued an administrative decision requiring that Internet access also be included in our reference interconnection offer for our wireline network. As a result, the billing arrangements between PT Comunicações and ISPs are now ruled by two billing regimes: (i) the reference Internet access offer, which is based on ANACOM's administrative decision of February 21, 2001, and (ii) the reference interconnection offer for our wireline business, which is based on ANACOM's administrative decision of March 16, 2004. The primary differences between the two billing regimes relate to origination prices, the manner in which ISP infrastructures are connected to

PT Comunicações' wireline network and billing arrangements. The reference interconnection offer for our wireline business has lower origination charges, involves the use of leased lines and does not require PT Comunicações to maintain billing arrangements with ISPs. The ISPs determine which billing regime will apply to their billing arrangements with PT Comunicações. See "*Item 4 Information on the Company Regulation Interconnection*". As a result, this administrative decision may reduce revenues of our wireline business.

Cost Reduction Program

Our principal costs include employee costs (including wages and salaries, post retirement benefits and work force reduction program costs), costs of telecommunications (principally accounting rate payments to other international telecommunications operators), costs of products sold, other general and administrative costs and depreciation and amortization. Since our formation in 1994, we have focused on consolidating operations, identifying administrative duplication and generally improving the efficiency of our operations.

In 2003, we reduced our workforce in Portugal by 1,530 employees. See "*Item 6 Directors, Senior Management and Employees Work Force Reductions*". We expect these workforce reductions to decrease our labor costs and increase productivity. Workforce reductions in our fixed line telephone services will continue to be a significant part of our cost management in 2004. We believe that the productivity of our fixed line telephone service unit is commensurate with European standards generally. We believe that there is potential for further efficiency gains as a result of the continued implementation of the current cost reduction programs and network modernization, as well as management's continuous efforts to identify other areas to improve our efficiency.

Competition and Pricing

Changes in the competitive environment in Portugal have led to a significant reshaping of our domestic businesses, a process that we expect will continue in coming years.

We face substantial and increasing competition. In the past we experienced limited or no competition in our principal business areas, except in our mobile business units. Since January 1, 2000, the telecommunications sector in Portugal has been open to full competition.

Our wireline telephone services face increasingly strong competition from mobile operators and other providers of wireline services. This resulted in decreases in revenues in wireline telephone services in 2003, 2002 and 2001. The market for mobile telephone services provided by TMN, our mobile subsidiary in Portugal, and by TMN's competitors, Vodafone Portugal and Optimus, has been growing at a fast pace. By the end of 2003, there were already approximately 89.8% active mobile telephone cards per 100 inhabitants in the Portuguese market, more than the number of wireline main lines. This growth comes as more residential subscribers of wireline services add additional mobile phones for family members and as businesses add additional mobile telephones for their employees.

One of the principal ways that mobile operators compete with our wireline telephone and mobile services is through pricing. From January 1, 1999, mobile operators have been allowed to establish direct international interconnections with mobile and wireline networks abroad and to by-pass our wireline network. Since then, Optimus, Vodafone Portugal and TMN have launched strong marketing campaigns for their international telephone services. Pricing competition is also increasing for domestic calls. See "*Item 4 Information On The Company Competition*".

The effect of full competition on our business depends partly on the prices that mobile and wireline network operators pay us for interconnection with our network. Since January 1, 2000, other companies may offer public wireline telephone services, and Portuguese law requires us to lease lines to

our competitors and allow competitors to interconnect to our network. Our interconnection prices are subject to regulatory review and must be based on the cost of providing the service.

The most recent version of our reference offer for local loop unbundling was published on September 15, 2003. PT Comunicações has made available to its competitors all of the local switches for remote and physical co-location, including co-mingling, where technical and space conditions are available, 59 of which are co-located. Our competitors are now able to gain access to our network's local loops, giving them direct access to our customers. In addition, following the liberalization of wireline telephone services in 2000, steps have been taken towards full liberalization of the market since the first quarter of 2001. On January 1, 2001, carrier pre-selection was introduced for local and regional calls. Number portability for wireline services was implemented on July 1, 2001. These changes to the wireline telephone services market have intensified competitive pressures on our wireline telephone services business, including pricing. See "*Item 4 Information on the Company Regulation*".

Market and Economic Developments in Brazil

A material portion of our business, prospects, financial condition and results of operations is dependent on general economic conditions in Brazil. Since 1998, we have made significant investments in telecommunications operators such as TCP, and in December 2002, we and Telefónica transferred our investments in Brazilian mobile operators to a 50/50 joint venture, Vivo, the largest provider of mobile telecommunications in the Brazilian market. The following significant factors have the potential to impact negatively our investments in Brazil, including Vivo, and our results of operations in Brazil, including Vivo's:

general economic conditions in Brazil and in other Latin American countries;

the devaluation of the Real, which could negatively affect the stability of the Brazilian economy;

changes in the Brazilian government's economic policy, including changes in the exchange control policy; and

high rates of inflation, as well as governmental measures put in place to combat inflation.

In December 2001, we recorded a provision for impairment amounting to €500 million. This provision included an estimated impairment of our investment in TCP amounting to €1,500 million, net of the estimated tax effect of €1,000 million resulting from the corporate restructuring of our mobile businesses, which was in progress at that date. During the fourth quarter of 2002, this provision was used to offset the impairment in the investment in TCP amounting to €1,141 million, following the contribution of this investment to Vivo.

Critical Accounting Policies under Portuguese GAAP

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with Portuguese GAAP. Our reported financial condition and results of operations are sensitive to accounting methods, assumptions and estimates that underlie preparation of the financial statements. We base our estimates on historical experience and on various other assumptions, the results of which form the basis for judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

We believe the following critical accounting policies involve the most significant judgments and estimates used in the preparation of our consolidated financial statements.

Accounting for long-lived assets. Fixed assets and intangible assets other than goodwill are recorded at their acquisition cost or revalued amount in the case of certain fixed assets. When such assets are acquired in a business combination, purchase accounting requires judgment in determining the

estimated fair value of the assets at the date of the acquisition and their useful lives over which the costs of acquiring these assets are charged to the income statement.

Other intangible assets and plant, property and equipment are depreciated when, due to events and circumstances arising in the period, impairments are identified. The determination of such impairments involves the use of estimates, which include, but are not limited to, the cause, the timing and the amount of the impairment. Among impairment indicators, Portugal Telecom typically considers obsolescence, physical damage, significant changes in their usage, performance below forecast, decreasing revenues and other external indicators. When impairment is deemed necessary in the light of those indicators, the recoverable value of the assets is estimated by Portugal Telecom's management. The recoverable value is the higher of the realizable value and the value in use. Impairment tests are performed by group of assets by comparing the recoverable value and the carrying value (when an impairment charge appears necessary, the amount recorded is equal to the difference between the carrying value and the recoverable value).

For assets destined to be kept and used, the recoverable value is most often determined on the basis of the value in use, representing the value of expected future economic advantages from its use and disposal. It is assessed notably by reference to discounted future cash flows determined using economic assumptions and forecast operating conditions used by the management of Portugal Telecom or by reference to the cost of replacement taking into account asset ageing or cost of technology. For assets destined to be divested, the recoverable value is determined on the basis of the realizable value, and this is assessed on the basis of market value.

Goodwill. The determination of goodwill is dependent on the allocation of the purchase price to the tangible and intangible assets acquired and the liabilities assumed. Such an allocation is based on management's judgment. The useful lives assigned to different goodwill are estimates based on management's assumptions and defined objectives at the time of the acquisition. As of December 31, 2003, the net book value of goodwill recorded in our balance sheet was approximately €1,284.2 million.

The recoverable value of goodwill is subject to review annually and when events or circumstances occur indicating that an impairment may exist. Such events or circumstances include significant adverse changes, other than temporary, in the business environment, or in assumptions or expectations considered at the time of the acquisition.

The necessity to record impairments is assessed by comparison of the carrying value of the investments and the corresponding fair value, which is estimated based on the discounted future cash flows determined using economic assumptions and forecast operating conditions used by Portugal Telecom's management.

These estimates, as well as the use of certain valuation methods, are the basis for the evaluation of the value of goodwill and therefore the amount of any impairment.

Deferred taxes. As of December 31, 2003, Portugal Telecom recorded deferred tax assets amounting to approximately €998.1 million, net of valuation allowances and deferred tax liabilities. This balance consists primarily of (i) temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes and (ii) tax losses carried forward mainly resulting from the corporate restructuring undertaken in 2002. The realization of deferred tax assets is reviewed by Portugal Telecom's management using each entity's tax results forecast based on budgets and strategic plans. Valuation allowances are considered in respect of deferred tax assets to the extent that the recovery of the related taxes is not considered probable. If Portugal Telecom's management were to consider that certain deferred tax assets for which allowances had been made were to be realized, a previously recorded valuation allowance would be fully or partially reversed.

Accrued post retirement liability. As of December 31, 2003, Portugal Telecom recorded an accrued post retirement liability amounting to approximately €1,256.0 million to cover for its unfunded obligations regarding pensions and post retirement health care benefits, net of the related deferrals determined under International Accounting Standard No. 19. We estimate our obligations regarding post retirement benefits based on actuarial valuations prepared annually by our independent actuaries, which use the projected unit credit method and consider certain demographic and financial assumptions. If we and our actuaries were to consider different assumptions from the ones that have been used in the actuarial valuations, the value of our accrued post retirement liability and related costs could differ from the amounts recorded in our financial statements.

Provisions for other risks and charges. Provisions are recorded when, at the end of the period, there is an obligation of Portugal Telecom to a third party which is probable or certain to create an outflow of resources to the third party, without at least equivalent return expected from the third party. This obligation may be legal, regulatory or contractual in nature. It may also be derived from the practice of Portugal Telecom or from public commitments having created a legitimate expectation for such third parties that Portugal Telecom will assume certain responsibilities.

To estimate the expenditure that Portugal Telecom is likely to bear to settle its obligation, Portugal Telecom's management takes into consideration all of the available information at the closing date for its consolidated financial statements. If no reliable estimate of the amount can be made, no provision is recorded; information is then presented in the notes to the financial statements.

Contingencies, representing an obligation which is neither probable nor certain at the time of drawing up the financial statements, or a probable obligation for which the cash outflow is not probable, are not recorded. Information about them is presented in the notes to the financial statements.

Because of the inherent uncertainties in the foregoing evaluation process, actual losses may be different from the original estimated amount provisioned at the closing date.

Revenue and expense recognition from telecommunications services. Revenues from telecommunications services are recognized when earned. Billings for these services are made on a monthly basis throughout the month. Operating revenues are reported on a gross basis, with the compensation paid to other telecommunications operators being accounted for as operating expenses in the same period the revenue is earned. Unbilled revenues from the billing cycle are estimated based on the minutes of usage of the period and the prior month's pattern of traffic revenues, and are accrued at the end of the month.

Unbilled expenses related with telecommunications costs incurred during the period are also estimated based on the traffic information regarding the usage of other operators' networks during the period and the prior month's pattern of telecommunications costs.

Differences between estimated and actual unbilled revenues and expenses, which are recognized in the following period, may impact our results of operations in the period that such differences are recorded.

Provision for doubtful accounts. The provision for doubtful accounts receivable is stated at the estimated amount necessary to cover potential risks in the collection of overdue accounts receivable balances. A determination of the amount of provisions required is made after careful analysis of the evolution of accounts receivable balances and our knowledge of our customers' financial situation. The required provisions may change in the future due to changes in economic conditions and our knowledge of specific issues. Future possible changes in recorded provisions would impact our results of operations in the period that such changes are recorded.

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Results of Operations

Our operating results reflect the changing patterns in our business described above in " *Overview*". The key changes over the course of 2001, 2002 and 2003 include:

increasing revenues from mobile services and from pay TV and Internet services;

decreasing wireline telephone service revenues; and

a high level of work-force reduction program costs in 2001 and 2003, as we focus on increasing the efficiency of our wireline businesses.

The following tables set forth the operating revenues of each of our major business lines, as well as our major operating costs and expenses, the years ended December 31, 2001, 2002 and 2003.

	Year Ended December 31,							
	2001		2002			2003		
	EUR Millions	% of Operating Revenues	% Increase of Item	EUR Millions	% of Operating Revenues	% Increase of Item	EUR Millions	% of Operating Revenues
Operating Revenues								
Wireline Businesses	2,412.1	42.12%	(5.74%)	2,273.6	40.73%	(5.96%)	2,138.1	37.02%
Retail	1,639.2	28.62%	(10.59%)	1,465.6	26.25%	(4.26%)	1,403.1	24.29%
Wholesale	356.2	6.22%	4.29%	371.5	6.65%	(15.18%)	315.1	5.45%
Data and Corporate	201.7	3.52%	12.02%	225.9	4.05%	0.33%	226.7	3.92%
Directories	136.8	2.39%	1.75%	139.1	2.49%	(2.19%)	136.1	2.36%
Sales	43.0	0.75%	(19.04%)	34.8	0.62%	5.66%	36.8	0.64%
Other	35.3	0.62%	4.14%	36.8	0.66%	(44.54%)	20.4	0.35%
Domestic Mobile Business								
(TMN)	1,171.9	20.46%	8.08%	1,266.6	22.69%	6.32%	1,346.7	23.32%
Services	1,007.9	17.60%	12.38%	1,132.7	20.29%	7.10%	1,213.2	21.00%
Sales	164.0	2.86%	(18.35%)	133.9	2.40%	(0.27%)	133.5	2.31%
Brazilian Mobile Business								
(Vivo)	1,401.2	24.47%	(13.10%)	1,217.6	21.81%	11.82%	1,361.5	23.57%
Services	1,178.7	20.58%	11.04%	1,048.6	18.79%	4.31%	1,093.8	18.94%
Sales	222.5	3.88%	(24.04%)	169.0	3.02%	58.43%	267.7	4.64%